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EXAMINING REGULATORY BURDENS—REGULATOR PERSPECTIVE

HEARING

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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EXAMINING REGULATORY BURDENS—REGULATOR PERSPECTIVE

Thursday, April 23, 2015

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 9:19 a.m., in room HVC–210, Capitol Visitor Center, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Pearce, Lucas, Posey, Westmoreland, Luetkemeyer, Stutzman, Mulvaney, Pittenger, Barr, Rothfus, Dold, Guinta, Tipton, Williams, Love; Clay, Hinojosa, Scott, Maloney, Sherman, Lynch, Capuano, Heck, Sinema, and Vargas.

Also present: Representative Duffy.

Chairman NEUGEBAUER. Good morning. The Subcommittee on Financial Institutions and Consumer Credit will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Examining Regulatory Burdens—Regulator Perspective." Before I begin, I would like to thank each of our witnesses for traveling all the way to Washington, D.C., and to the Capitol Visitor Center. Not only is it a long way to Washington, D.C., but it is a long way to the Visitor Center. So you get double credit for your efforts this morning.

This hearing is starting a little bit earlier than normal today, because this was originally scheduled to be a full work day, but now is a getaway day. And we are going to have votes—fortunately, later in the morning than I anticipated—around 11:40 or 12:00. So that should give us time to, I think, have a pretty robust hearing.

At this time, I would like to recognize myself for 5 minutes to give an opening statement. Today this subcommittee will continue its examination of the regulatory burdens facing community financial institutions and the resulting impact on the American consumer. The full Financial Services Committee has heard an overwhelming amount of testimony highlighting the plight of our Main Street financial institutions, institutions that are disappearing at an average rate of one every single day.

We have heard from hardworking Americans in communities across the country that they are losing their financial independ-

ence. These consumers face difficulties in obtaining mortgage credit and the threat of financial products disappearing. Each one of us in this room has an obligation to our constituents to take seriously regulatory reform for these institutions and the American consumer.

Unfortunately, some of my colleagues on the other side of the aisle and in the upper chamber have suddenly changed course in their efforts to work in a bipartisan manner. Curiously, we have seen bills that were bipartisan last year that have been very difficult to pass this year.

We have seen Democratic-led bipartisan bills that passed out of our committee blocked going to the Floor all in an effort to protect the Dodd-Frank Act. As a result, Republicans are left without a dancing partner in trying to reverse this trend of "too-small-to-succeed."

In my district, and I suspect in many of my colleagues' districts, this is not an option. So today I am pleased to welcome our witnesses from the Federal and State financial regulators. These agency representatives will provide an important perspective on the regulatory framework facing our community financial institutions. I suspect many of them have heard the same stories that members of this subcommittee have heard. However, these agencies are in a unique position. They have the authority, in most cases, to write rules that can begin to change the condition of "too-small-to-succeed."

Some have done a better job than others. Today this subcommittee will address two overreaching regulatory issues.

First, how does the supervision and examination function of these agencies impact community financial institutions, and are there ways we can improve that process?

And second, how do these agency rulemakings limit the operational activities of community financial institutions? And further, how do these regulations impact consumer choices and availability of credit?

Each one of your agencies holds a piece of the regulatory burden puzzle that must be explored. For example, community banks have undergone significant capital restructuring as a result of the Basel capital requirements.

Credit unions are in the midst of moving to their own new capital structure that could result in considerable cost. Operation Choke Point has severely fractured any trust in the supervision and examination process between financial institutions and regulatory agencies.

Some consumer protection rules have literally caused products to disappear, as was the case in bank deposit advance products. In total, these regulatory issues continue to drive market consolidation and to harm the experience of consumers in the financial marketplace.

In closing, I am reminded of a quote from a recent Harvard study about community banks: "Their competitive advantage is a knowledge in the history of their customers and a willingness to be flexible." I like this quote because it is the very definition of banking relationships, particularly in community banks and credit unions.

In my district, the 19th District of Texas, we need relationship banking. My constituents want to know their banker. Their local banker wants to be flexible and to find ways to help his neighbor realize the dream and reach financial independence. It is my hope that today we can begin to restore some bipartisanship and work together to help our constituents on Main Street reach their financial dreams and enable our economy to reach its full potential.

The Chair now recognizes the ranking member of the subcommittee, the gentleman from Missouri, Mr. Clay, for 2 minutes.

Mr. CLAY. Thank you, Mr. Chairman. I appreciate you calling this hearing. And I certainly appreciate your common-sense approach to how we go forward as a subcommittee.

I welcome today's testimony from our panel of regulators. And I view this morning's hearing as an important opportunity for regulators to make their case for the work that they are already doing in tailoring their regulatory approaches to the size, complexity, and risk profiles of our community-based financial institutions. In particular, I look forward to a better understanding of how the rulemaking process already lends itself to agency considerations of cost and benefits, the progress of ongoing agency reviews of existing rules that are already happening under the Economic Growth and Paperwork Reduction Act, the various exemptions that regulators have already extended to community banks and small businesses, and the value of asset thresholds to regulators in identifying opportunities for targeted regulatory relief.

My hope is that this morning's testimony will form the basis of responsible and targeted regulatory relief proposals that strike the proper balance between consumer protection and safety and soundness, and that calibrate regulatory approaches to the actual risks that community-based financial institutions pose.

Mr. Chairman, thank you again, and I yield back the remainder of my time.

Chairman NEUGEBAUER. I thank you.

Are there any other Members on your side who would like to make an opening statement? We still have a little time left.

Mr. CLAY. I don't see any.

Chairman NEUGEBAUER. Then, I will now introduce our panel. First, Ms. Doreen Eberley is the Director of the FDIC's Division of Risk Management Supervision. She is responsible for FDIC's programs designed to promote financial institution safety and soundness and those institutions' adherence to the FDIC statutes and regulations. She has had a distinguished career at the FDIC, where she has served as Acting Deputy to FDIC Chairman Sheila Bair and Acting Chairman Martin Gruenberg.

Prior to joining the FDIC, she served on the professional staff of the U.S. House of Representatives Committee on Banking and Financial Services. And also, under the fellowship program during the 105th Congress.

Ms. Eberley holds a B.A. in economics from Cornell University and an MBA from Emory.

Second, Ms. Maryann Hunter is the Deputy Director of the Division of Bank Supervision and Regulation at the Board of Governors of the Federal Reserve System. She was responsible for the Federal Reserve's program for supervision and risk management, and over-

sees the supervision of U.S. banking organizations and foreign banking organizations operating in the United States.

Prior to joining the Board of Governors staff, Ms. Hunter held a number of high-level positions in the Federal Reserve Bank in Kansas City. She started her career at the Federal Reserve as an examiner in 1981, and was promoted to Senior Vice President and Officer in Charge of Supervision in 2000. She holds a B.A. from the Pennsylvania State University and an MPP degree from the University of Michigan's Ford School of Public Policy.

Third, Mr. Toney Bland is the Senior Deputy Comptroller for Midsize Community Bank Supervision in the Office of the Comptroller of the Currency. In this role, Mr. Bland is responsible for supervising nearly 1,800 national banks and Federal savings associations, as well as 2,000 OCC employees. He serves as a member of OCC's Executive Committee, and the Committee on Bank Supervision.

Mr. Bland previously served as Deputy Comptroller for the agency's northeastern district, where he was responsible for the oversight of more than 300 community banks and Federal savings associations, independent national trust companies, and independent data service providers.

Mr. Bland received his bachelor of science degree in business administration and economics from Carroll University in Wisconsin.

Fourth, Mr. Larry Fazio serves as director of the Office of Examination and Insurance at the National Credit Union Administration. In this role, he is responsible for providing leadership over the agency's examination and supervision program. He has had a long career in supervision and examination at the NCUA, having previously served as supervision analyst, supervisory examiner, and director of risk management. Mr. Fazio graduated from Lewis University with a degree in accounting. He is a certified management accountant and has a master's degree in organizational management from George Washington University.

Fifth, Mr. David Silberman serves as the Associate Director of the Office of Research, Markets, and Regulations at the Consumer Financial Protection Bureau. Prior to joining the CFPB, Mr. Silberman had a long career at the AFL-CIO where he served as deputy general counsel. While there, he helped create an organization to provide financial services to union members. Mr. Silberman went on to serve as president and CEO of Union Privilege, and later as director of the AFL-CIO Task Force in Labor Law.

Prior to joining the CFPB implementation team, Mr. Silberman served as general counsel and executive vice president of Kessler Financial Services, a privately held company focused on creating and supporting credit cards and other financial services to membership organizations.

Mr. Silberman began his career as a law clerk to Justice Marshall, and is a member of the law firm Bredhoff & Kaiser.

And I would now like to turn to a friend from Texas, Mr. Williams, to recognize a very special member of the panel today.

Mr. WILLIAMS. Thank you, Chairman Neugebauer. This morning it is a privilege and an honor to introduce Texas Banking Commissioner, and my constituent, Charles Cooper.

A native Texan, Mr. Cooper holds a BBA degree in finance and economics from Baylor University, and is also a graduate of the Southwestern Graduate School of Banking at Southern Methodist University.

Charles G. Cooper was appointed Texas Banking Commissioner by the Texas Finance Commission on December 1, 2008.

Mr. Cooper began his career in banking in 1970 with the Federal Deposit Insurance Corporation in the Dallas region. His career in the banking industry spans over 40 years, and includes senior level positions in both the public and private sectors.

As Texas Banking Commissioner, his responsibilities include the chartering, regulation, supervision, and examination of 263 Texas State-chartered banks with aggregate assets of approximately $236 billion, in addition to department supervisors trust companies, foreign bank agencies and branches, prepaid funeral licenses, money services businesses, perpetual care cemeteries, and private child support for enforcement agencies. He also serves as vice chairman of the Conference of State Bank Supervisors.

The subcommittee looks forward to Mr. Cooper's testimony. I want to welcome him here to Washington.

And I yield back, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

Each of you will be recognized for 5 minutes to give your oral presentations, and without objection, each of your written statements will be made a part of the record.

And we will start with you, Ms. Eberley. You are now recognized for 5 minutes.

DOREEN R. EBERLEY, DIRECTOR, DIVISION OF RISK MANAGEMENT SUPERVISION, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Ms. EBERLEY. Thank you, Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee. I appreciate the opportunity to testify on behalf of the FDIC on regulatory relief for community banks.

As the primary Federal regulator for the majority of community banks, the FDIC has a particular interest in understanding the challenges and opportunities they face.

Community banks provide traditional relationship-based banking services to their communities. While they hold just 13 percent of all banking assets, community banks account for about 45 percent of all of the small loans to businesses and farms made by insured institutions. Although 448 community banks failed during the recent financial crisis, thousands of community banks did not. That is a fact, and that is the vast majority.

Institutions that stuck to their core expertise weathered the crisis. The highest failure rates were observed among non-community banks and among community banks that departed from the traditional model and tried to grow rapidly with risky assets, often funded by volatile non-core and often non-local brokered deposits.

The FDIC is keenly aware that regulatory requirements can have a greater impact on smaller institutions, which operate with fewer staff and other resources than their larger counterparts. Therefore, the FDIC pays particular attention to input community

bankers provide regarding regulations, and the impact regulations may have on smaller and rural institutions that serve areas that otherwise would not have access to banking services.

The FDIC and the other regulators are actively seeking input from the industry and the public on ways to reduce regulatory burden through the Economic Growth and Regulatory Paperwork Reduction Act process, which requires the Federal financial regulators to periodically review our regulations to identify any that are outdated or otherwise unnecessary. As part of this process, the agencies are jointly requesting public comment on all areas of our regulations.

We are also conducting regional outreach meetings involving the public, the industry and other interested parties.

In response to what we heard in the first round of comments, the FDIC already has acted on regulatory relief suggestions where we could achieve rapid change. In November, we issued two financial institution letters, or FILs, responding to suggestions we reviewed from bankers. The first FIL released questions and answers about the deposit insurance application process. Commentors had told us that a clarification of the FDIC's existing policies would be helpful.

The second FIL addressed new procedures that eliminate or reduce the need to file applications by institutions wishing to conduct permissible activities through certain bank subsidiaries organized as limited liability companies, subject to some limited documentation standards. This will significantly reduce application filings in the years ahead.

The FDIC also takes a risk-based approach to supervision which recognizes that community banks are different and should not be treated the same. This approach is clear in how we train our examiners and how we conduct our examination processes.

Every FDIC examiner is initially trained as a community bank examiner through a rigorous 4-year program. As a result, each examiner gains a thorough understanding of community banks before becoming a commissioned examiner.

The vast majority of examiners in our 83 field offices nationwide are community bank examiners.

Institutions with lower risk profiles, such as most community banks, are subject to less supervisory attention than those with elevated risk profiles. Well-managed banks engaged in traditional non-complex activities receive periodic safety and soundness and consumer protection examinations that are carried out over a few weeks. In contrast, the very largest institutions that FDIC supervises receive continuous safety and soundness supervision and ongoing examination carried out through targeted reviews during the course of an examination cycle.

The FDIC also considers the size, complexity, and risk profile of institutions during the rulemaking and supervisory guidance development processes, and on an ongoing basis through the feedback we receive from community bankers and other stakeholders. Where possible, we scale our regulations and policies according to these factors.

As we strive to minimize regulatory burden on community banks, we look for changes that can be made without affecting safety and soundness. For example, we believe that the current $500 million

threshold for the expanded 18 month examination period could be raised. In addition, we would support Congress' efforts to reduce the privacy notice reporting burden.

In conclusion, the FDIC will continue to look for ways to achieve our fundamental objectives of safety and soundness and consumer protection in ways that do not involve needless complexity or expense for community banks.

We look forward to working with the committee in pursuing these efforts.

Thank you.

[The prepared statement of Director Eberley can be found on page 104 of the appendix.]

Chairman NEUGEBAUER. Thank you.

Now, Ms. Hunter, you are recognized for 5 minutes.

STATEMENT OF MARYANN F. HUNTER, DEPUTY DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (FED)

Ms. HUNTER. Thank you. Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee, I appreciate the opportunity to testify today on the important topic of regulatory relief for community financial institutions.

As noted in the introduction, I began my career more than 30 years ago as a community bank examiner and eventually became the officer in charge of supervision at the Federal Reserve Bank of Kansas City. Thus, I have seen firsthand the need to balance effective supervision and regulation to ensure safety and soundness, while not subjecting small institutions to unnecessary regulatory requirements that could constrain their capacity to serve their customers and communities.

In recent years, the Federal Reserve has taken several measures to tailor regulations, policies, and supervisory activities to the risks at community banking organizations and to make our supervisory program more efficient and less burdensome for well-run institutions. For example, we have recently completed a review of supervisory guidance for community and regional organizations, to make sure that our expectations for examiners and bankers are appropriately aligned with the current banking practices and risks.

This review is likely to result in the elimination of some guidance that is no longer relevant to current supervisory and banking industry practices.

We continue to build upon our longstanding risk-focused approach to supervision, reviewing field procedures, refining training programs and developing automated tools for examiners to focus examiner attention on higher risk activities, thus reducing some of the work at lower-risk, well-managed community banks.

Furthermore, we have developed programs to conduct more examination work offsite, such as the loan review, to reduce the time that examiners physically spend in the bank.

The Federal Reserve very recently took action to further reduce burden for smaller institutions. The Board issued a final rule that expands the applicability of its small bank holding company policy

statement to institutions with up to a billion dollars in assets, provided that they meet certain qualitative requirements.

And it also applies the statement to certain savings and loans holding companies, to address their burden.

This expansion covers approximately 720 savings and loan holding companies and bank holding companies.

Going forward, this means that 89 percent of all bank holding companies and 81 percent of all savings and loan holding companies will be covered under the policy statement.

The policy statement facilitates local ownership of small community banks and savings associations by allowing their holding companies to operate with higher levels of debt than would normally be permitted. Holding companies that qualify for the policy statement are excluded from consolidated capital requirements.

In a related action, the Board took steps to relieve the regulatory reporting burden for the affected institutions by eliminating the quarterly and more complex consolidated financial reporting requirement, and instead required parent-only financial statements semiannually.

In addition to these actions, the Federal Reserve is participating with the other Federal banking agencies in a review to identify banking regulations that are outdated, unnecessary or unduly burdensome, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, or, as it is also known, the EGRPRA review.

We are working closely with the OCC and the FDIC to seek public comment on regulations, and are jointly holding outreach meetings to get feedback directly from bankers and community groups about ways to reduce burden related to rules and examination practices.

To date, the meetings held in Los Angeles and Dallas have yielded some useful and specific suggestions for consideration.

The agencies have also recently expanded the scope of regulations covered by the review to include those that are relatively new. We are committed to listening to bankers' concerns and working with the other Federal agencies, as appropriate, to consider and assess the impact of potential changes identified through the EGRPRA review process.

Let me conclude by saying that the Federal Reserve is committed to taking a balanced supervisory approach that fosters safe and sound community banks and fair treatment for consumers, and encourages the flow of credit to consumers and businesses.

To achieve that goal, we will continue to work to make sure that regulations, policies, and supervisory activities are appropriately tailored to the level of risks at these institutions.

Thank you for inviting me to share the Federal Reserve's views on the issues affecting community banks. I would be pleased to answer any questions you may have.

[The prepared statement of Deputy Director Hunter can be found on page 148 of the appendix.]

Chairman NEUGEBAUER. Thank you, Ms. Hunter.

Mr. Bland, you are recognized for 5 minutes.

STATEMENT OF TONEY BLAND, SENIOR DEPUTY COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)

Mr. BLAND. Thank you, Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee. Thank you for the opportunity to appear before you today to discuss the challenges facing community banks and Federal savings associations and the actions that the OCC is taking to help these institutions address regulatory burdens.

I have been a bank examiner for more than 30 years. And I have seen firsthand the vital role that community banks play in meeting the credit needs of consumers and small businesses across the country.

At the OCC, we are committed to supervisory practices that are fair and reasonable, and to fostering a climate that allows for well-managed community banks to grow and thrive.

We tailor our supervision to each bank's individual situation, taking into account the product and services it offers as well as its risk profile and management team.

Given the wide array of institutions we supervise, the OCC understands that a one-size-fits-all approach to regulation does not work. Therefore, to the extent that a law allows, we factor these differences in the rules we write and the guidance we issue.

My written statement provides several examples of the commonsense adjustments we have made to recent regulations to accommodate community bank concerns.

Guiding our consideration of every proposal to reduce the burden on community banks is the need to ensure that fundamental safety and soundness and consumer protection safeguards are not compromised. Within this framework, to date we have developed three regulatory relief proposals that we hope Congress will consider favorably.

We are also undertaking several efforts to identify and mitigate other regulatory burdens through our regulatory review process.

The first proposal we submitted to Congress would exempt some 6,000 community banks from the Volcker Rule. As the vast majority of banks under $10 billion in asset size do not engage in the proprietary trading or covered funds activities that the statute sought to prohibit, we do not believe they should have to commit the resources to determine if any compliance obligations under the rule would apply.

We do not believe that this burden is justified by the nominal risk that these institutions could pose to the financial system.

We are also supporting current law to allow more well-managed community banks to qualify for a longer, 18-month examination cycle. Raising the threshold from $500 million to $750 million for banks that would qualify for this treatment would cover more than 400 additional community banks.

We also support providing more flexibility for Federal thrifts, so that those thrifts that wish to expand their business model and offer a broader range of services to their communities may do so without the burden and expense of a charter conversion.

Under our proposal, Federal thrifts could retain their current governance structure without unnecessarily limiting the evolution of their business plan.

As a supervisor of both national banks and Federal thrifts, we are well-positioned to administer this new framework without requiring a costly and time-consuming administrative process.

I am pleased that members of this subcommittee, including Representatives Rothfus, Barr, and Tipton, have introduced legislation consistent with some of our proposals to provide regulatory relief to community banks.

I am also hopeful that the ongoing efforts to review current regulations to reduce or eliminate burden will bear fruit.

I have participated in the first two public EGRPRA meetings in Los Angeles and Dallas, where regulators heard ideas to reduce burden from a number of interested stakeholders. The agencies are currently evaluating the comments received from these meetings and from the public comment process.

While this process will unfold over a period of time, the OCC will not wait until it is completed to implement changes where a good case is made for relief or to submit legislative ideas identified through this process to Congress.

Separately, the OCC is in the midst of a comprehensive, multiphase review of our own regulations and those of the former Office of Thrift Supervision (OTS) to reduce duplication, promote fairness of supervision, and create efficiencies for national banks and Federal savings associations.

We are currently reviewing comments received from the first phase of our review, focused on corporate activities and transactions.

Finally, we are continually looking for innovative ways to reduce burden. Last February, the OCC published a paper that focused on possibilities for community banks to collaborate to manage regulatory requirements, trim cost, and better serve their customers.

We believe there are opportunities for community banks to work together to address the challenges of limited resources and acquiring needed expertise.

In closing, the OCC will continue to carefully assess the potential effect that current and future policies and regulations may have on community banks. And we will be happy to work with the industry and the committee on additional ideas or proposed legislative initiatives.

Again, thank you for the opportunity to appear today. I would be happy to respond to questions.

[The prepared statement of Deputy Comptroller Bland can be found on page 60 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Bland.

Mr. Fazio, you are now recognized for 5 minutes.

STATEMENT OF LARRY FAZIO, DIRECTOR, OFFICE OF EXAMINATION AND INSURANCE, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)

Mr. FAZIO. Good morning, Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee. Thank you for the invitation to discuss regulatory relief for credit unions.

NCUA regulates 6,273 credit unions with $1.1 trillion in assets that serve 99.3 million members. More than three-quarters of these credit unions have less than $100 million in assets. And all but 227 have less than $1 billion in assets.

Therefore, most member-owned, locally-driven credit unions could be considered community financial institutions.

Because credit unions generally have fewer resources available to respond to marketplace, technological, legislative and regulatory changes, NCUA recognizes and acts continually to fine tune our rules to remove any unnecessary burden on credit unions.

In protecting the safety and soundness of credit unions, the savings of their members, the share insurance fund, and taxpayers, NCUA employs a variety of targeting strategies.

For example, we will fully exempt small credit unions from certain rules. We use graduated requirements as size and complexity increase for others. And we incorporate practical compliance approaches in agency guidance.

In short, we strive to balance maintaining prudential standards with minimizing regulatory burden. Since 1987, NCUA has undertaken a rolling 3-year review of all of our regulations, and NCUA is once again voluntarily participating in the current EGRPRA review.

In response to stakeholder comments received during the first EGRPRA notice, we have established two internal working groups to consider possible changes in the areas of field of membership and secondary capital.

We have also moved swiftly on the supervisory front to expedite secondary capital requests from low-income credit unions.

Over the past 3 years, NCUA has taken 15 additional actions through the agency's regulatory modernization initiative to cut red tape and provide lasting benefits to credit unions.

This includes easing eight regulations, including modernizing the definition of small credit unions to prudently exempt thousands of credit unions from several rules, streamlining three processes, including facilitating more than 1,000 new low-income designations and expediting examinations at all small credit unions, and issuing four legal opinions allowing more flexibility in credit union operations.

In February, the NCUA Board issued a proposed rule to further increase the asset threshold for defining a small entity under the Regulatory Flexibility Act to $100 million. If finalized as proposed, this change would provide special consideration of regulatory relief in future rulemaking for three out of four credit unions.

The NCUA Board is fully committed to continuing to provide regulatory relief. NCUA is now working to ease rules on secondary capital, member business lending, fixed assets, asset securitization, and fields of membership.

Next week, in fact, the Board will finalize a rule to simplify how Federal credit unions add groups to their fields of membership.

Concerning legislation, NCUA appreciates the committee's recent efforts to enact laws to provide share insurance coverage for lawyers' trust accounts and enable federally-insured financial institutions to offer prize-linked savings accounts.

Going forward, NCUA would urge Congress to provide regulators with flexibility in writing rules. Such flexibility would better allow us to scale rules based on size or complexity to effectively limit additional regulatory burdens on smaller credit unions.

In this Congress, NCUA supports several targeted bipartisan bills. For example, we support H.R. 989 by Congressmen King and Sherman to allow healthy, well-managed credit unions to issue supplemental capital that would count as net worth, H.R. 1188 by Congressmen Royce and Meeks to modify the cap on member business lending, and H.R. 1422 by Congressmen Royce and Hoffman, to provide parity between credit unions and banks on the treatment of one- to four-unit, non-owner- occupied residential loans by exempting such loans from the member business lending cap.

NCUA also would support legislation to permit all Federal credit unions to add underserved areas to their fields of membership. Additionally, we request congressional consideration of legislation to enable NCUA to examine third-party vendors, a move that could provide a measure of regulatory relief.

The change could easily save credit unions and NCUA valuable time by eliminating the need to mitigate the same issue repeatedly at hundreds of credit unions.

In closing, NCUA remains committed to providing responsible regulatory relief. We stand ready to work with Congress on related legislative proposals.

Thank you, and I look forward to your questions.

[The prepared statement of Director Fazio can be found on page 121 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Fazio.

Mr. Silberman, you are now recognized for 5 minutes.

STATEMENT OF DAVID SILBERMAN, ASSOCIATE DIRECTOR, RESEARCH, MARKETS, AND REGULATIONS, CONSUMER FINANCIAL PROTECTION BUREAU (CFPB)

Mr. SILBERMAN. Thank you, Mr. Chairman.

Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee, thank you for the opportunity to testify today about the Consumer Financial Protection Bureau's work to strengthen our financial system so that it better serves consumers, responsible businesses, and our economy as a whole.

As you know, the Bureau is the Nation's first Federal agency whose sole focus is protecting consumers in the financial marketplace through fair rules, based on research and quantitative analysis, consistent oversight and appropriate enforcement with respect to the institutions within our jurisdiction, and through broad-based consumer engagement, the Bureau is working to restore consumer trust in the financial marketplace.

The Bureau does not supervise community banks or credit unions, but our rules of course impact these institutions. The division I lead, the Division of Research, Markets and Regulations, is responsible for articulating a research-driven, evidence-based, and pragmatic perspective on consumer financial markets, and developing rules grounded in that perspective to ensure that consumer financial markets function in a fair, transparent, and competitive manner.

As such, the Bureau is committed to regulations that are carefully calibrated so that as we fulfill our mandate to protect consumers, we are mindful of the impact of compliance on financial institutions and responsive to those concerns. We engage in rigorous evaluation of the effects of proposed regulations on both consumers and the covered persons throughout our rulemaking process and maintain steady dialogue with stakeholders.

Congress also specifically mandated the agency to undertake a regulatory review process. The Dodd-Frank Act requires that within 5 years after the effective date of any significant rule, the Bureau must assess the rule's effectiveness in meeting the purposes and objectives of the Act and the goals for the particular rule.

Beginning in 2011, the Bureau demonstrated an early commitment to addressing unnecessary burdens by issuing a request for information to help identify priorities for streamlining inherited regulations.

Through that process, we pinpointed a number of areas for review. For example, we identified a requirement that certain fee disclosures must be posted on automated teller machines as a candidate for elimination. The Bureau provided technical assistance to Congress on this issue, which took corrective action.

Additionally, the Bureau identified certain requirements regarding the delivery of annual privacy notices under the Gramm-Leach-Bliley Act as potentially redundant. Last fall, the Bureau finalized a rule to allow banks and non-bank financial institutions, under certain conditions, to post privacy notices online instead of having to mail them to consumers, resulting in a potential savings to the industry of $17 million annually.

The Bureau likewise has been sensitive to regulatory burdens in the rules we have adopted. As directed by Congress in the Dodd-Frank Act, the Bureau issued a series of mortgage rules, the majority of which took effect in January of 2014.

Those rules were designed to address a variety of practices that contributed to the mortgage crisis and ensuing financial meltdown. As part of the work to reform the mortgage market, the Bureau developed a set of special provisions to provide small creditors, mostly community banks and credit unions, greater leeway to originate Qualified Mortgages (QMs).

For example, we provided a 2-year transition period, during which balloon loans made by small creditors and held in portfolio can generally be treated as QMs regardless of where the loans are originated.

We also provided that after that period, balloon loans originated by small creditors that predominantly serve rural or underserved areas would be treated as QMs. We then committed to a thorough review of whether our definitions of "rural or underserved" and "small creditor" could be better calibrated.

After undertaking considerable analysis, the Bureau recently proposed to expand the definition of "small creditor" by adjusting the origination limit to encourage more lending by these small local institutions. We also proposed to expand the definition of "rural area" to address access to credit concerns.

To further address compliance costs, the Bureau has developed a unique regulatory implementation program. For example, Con-

gress directed the Bureau to combine the required mortgage disclosure forms under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA).

Since our integrated disclosure rule was first issued in November 2013, the Bureau has engaged directly and intensively with financial institutions and vendors, including efforts focused on the needs of smaller institutions.

We expect to continue working with these stakeholders to answer questions and evaluate feedback as the integrated disclosure rule is implemented.

In closing, the premise at the heart of our mission is that consumers deserve to be treated fairly in the financial marketplace. A deep and thorough understanding of the marketplace is essential to accomplish the Bureau's mission and ensure the stability of the financial system and our economy as a whole.

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

[The prepared statement of Associate Director Silberman can be found on page 165 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Silberman.

And, Mr. Cooper, you are now recognized for 5 minutes.

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

Mr. COOPER. Chairman Neugebauer, Ranking Member Clay, and distinguished members of the subcommittee, my name is Charles Cooper. I am the commissioner of the Texas Department of Banking and also serve as vice chairman of the Conference of State Bank Supervisors.

It is my pleasure to testify here today on behalf of CSBS on this most important topic.

I have more than 45 years in the financial services industry, both as a banker and as a State and Federal regulator.

Over these many years, few things have become more evident than the value of community banks. They are vital to the economy, job creation, and financial stability.

I have also seen many swings of the regulatory pendulum. Extreme swings to either side are wrong. Regulators must constantly improve the way we conduct supervision to ensure a balanced approach.

I would like to point out that the sheer volume of regulation confounds the best of our banks, and these regulations keep on coming. This emphasizes the importance of the ongoing EGRPRA review. This process needs to receive the priority treatment of everyone.

Many times, it is not the law or the regulation itself that creates the excessive regulatory burden, but the interpretation and supervisory techniques utilized. One-size-fits-all supervision that has unintended negative consequences should be curtailed. Being a bank examiner is a tough job. It requires education and experience. It also requires sound judgment.

I have generally found that field examiners in local offices do an extraordinary job. The process begins to break down when the decisions are made from afar.

As State regulators, we have found that community banks cannot be defined by simple line drawing based on asset thresholds. While asset size is relevant, there are other factors such as market area, funding sources, and relationship lending. We need a process that utilizes these factors and provides flexibility in how they are weighed and considered.

CSBS commends Congress for passing a law requiring that at least one member of the Federal Reserve Board have experience as a supervisor of community banks or as a community banker.

We also support H.R. 1601, which reaffirms the existing legal requirement that the FDIC Board include an individual with State regulatory experience.

A seat at the table will not automatically result in a right-sized regulatory framework. We must also understand the state of community banking. This is why CSBS partnered with the Federal Reserve to attract new research on community banking. This will help us develop a system of supervision that provides for a strong, enduring future for the dual banking system.

In addition to banks, State regulators regulate other financial services industries. Effective supervision of our diverse financial system requires effective regulatory tools. To help accomplish this, State regulators developed the Nationwide Multistate Licensing System Registry, or NMLS.

CSBS commends the House for unanimously passing H.R. 1480, which supports State regulators' expanded use of NMLS as a licensing system. We are also working with Congress to enable NMLS to process background checks for other non-mortgage licensees in the same efficient manner they are processed for mortgage providers.

Today, there are 6,423 banks. As you know, that number decreases daily. State bank regulators have chartered and now regulate more than 75 percent of these banks. Regardless of the charter or agency, we are all in this together. We are stewards of the entire financial services ecosystem. We must ensure that sound judgment and appropriate flexibility are central to our supervisory approach.

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

[The prepared statement of Commissioner Cooper can be found on page 76 of the appendix.]

Chairman NEUGEBAUER. Thank you, Mr. Cooper.

I want to give this panel an "A" because every one of you stayed within your 5-minute time allocation.

And I want that to be an example for my colleagues. We have great participation today, and what I would really like to do is get through, at least for every Member to ask a question. So if you get to the end of your time and you ask a very long question, you are going to have to get that answered in writing, because I am going to be fairly efficient about making sure everybody stays within the 5-minute timeline.

I am now going to recognize myself for 5 minutes for questions.

Mr. Bland, first of all, I would like to thank the OCC for being one of the first agencies to put forth some legislative proposals to help bring some regulatory relief for our community financial institutions.

So, let's talk about your EGRPRA process. Which of the Dodd-Frank rules are currently a part of that process that you are reviewing?

Mr. BLAND. Chairman Neugebauer, when we initially started the EGRPRA process, Dodd-Frank wasn't part of the review. This month we have agreed, going forward, that those rules that have been implemented will be subject to the future EGRPRA hearings and the comment periods.

Chairman NEUGEBAUER. Can you give an example of maybe one of those that you might be looking at?

Mr. BLAND. I look at the stress test process we put in for institutions. That is one that will be subject to review.

Chairman NEUGEBAUER. I am glad to hear that because I think that is an important part of it. And I hope your other colleagues will be doing the same.

Mr. Fazio, the NCUA's risk-based capital rule has been one of the most commented-upon proposals in the agency's history. You are wrapping up, I guess, what is the second window of the proposed rule. One of the NCUA Board members has questioned the rule's legality.

Do you have confidence that the NCUA is getting this move to risk-based capital structure right?

Mr. FAZIO. I do, Mr. Chairman. We spent a lot of time with the second proposal, looking at comments we received on the first proposal, doing additional research, and consultation with various parties.

In addition to looking at the policy matters, the risk weights and so forth, we spent a lot of extra time and research on the legal matters as well.

Our general counsel, as well as some independent external counsels that we used, are confident that what we are proposing is within the NCUA's Board's authority to propose.

Chairman NEUGEBAUER. One of the concerns that I have heard about the new capital system is it requires under a new capital structure, and particularly, I am concerned about the capital cushions and a practice where credit unions were required to hold more than regulatory mandates would go up dramatically.

Can you address the amount of new capital that may be required in the practice of capital cushions?

Mr. FAZIO. The concept of a capital cushion is not really a direct function of the rule itself. It is a choice that credit unions make when they are seeking to hold a cushion, if you will, or a buffer above what the minimum that is required by the regulation specifies.

We have done a great deal of analysis on levels of capital credit unions would have to hold to be in compliance, but I would first point out that three-quarters of all credit unions are exempt under this second proposal from this rule. So it only affects credit unions that are over $100 million in assets, which is one quarter or one out of every four credit unions, about 1,400 institutions.

Of those, only 29 would see a decline in their capital levels below well-capitalized. For those 29 credit unions, if they were to solve their capital deficiency through just adding capital to the numerator of that equation, it would be roughly $53 million in extra capital.

So it is a relatively modest impact on those credit unions and their operations. Those 29 credit unions, for context, hold $13 billion in assets. So it is a relatively modest impact currently.

But it is effective in picking up outliers, making sure that credit unions that have too much risk relative to their capital levels to absorb that risk are identified properly and incentivized to hold appropriate capital levels.

Chairman NEUGEBAUER. Thank you.

Mr. Cooper, it is my understanding that the States have considerable authority to regulate and to enforce the law when it comes to short-term, small-dollar, credit or payday loans.

Can you describe the authority that States have to regulate these products?

Mr. COOPER. Mr. Chairman, first of all the banking department does not directly regulate this industry. One of our sister agencies does.

But generally speaking, the State authority obviously is predicated on State law and it is—one of the things it is directed to do is to make sure that they are operating legally, legally licensed, operating within their license, and also that disclosure to the customer is most important.

Chairman NEUGEBAUER. Just quickly, Mr. Silberman, you have both research and regulations. Can you identify a State that lacks sufficient authority to regulate these products?

Mr. SILBERMAN. I see time is up, Mr. Chairman. Do you want me to answer?

Chairman NEUGEBAUER. Yes, quickly.

Mr. SILBERMAN. We have not thought about a State that doesn't have authority. Many of the States that have State regulators have talked to us about problems they have with respect to Internet payday lending and lending that is done through tribal entities that are outside their jurisdiction. So there are some gaps in States' ability to regulate.

But beyond that, our mission is to enforce Federal law, consumer protection law, which establishes a floor for consumers throughout the United States.

Chairman NEUGEBAUER. I thank the gentleman. And I now recognize the ranking member, Mr. Clay from Missouri, for 5 minutes.

Mr. CLAY. Thank you, Mr. Chairman.

This is a panel-wide question: All of you identified ongoing internal and external reviews of existing rules. How can smaller regulated entities engage regulators in expressing their specific concerns about particular rules, supervisory policies or enforcement action? What are the access points for smaller regulated entities seeking to inform your agency's policies, such as, do your agencies have liaisons and ombudsmen that specifically address the concerns of smaller entities?

Let's start with Ms. Eberley.

Ms. EBERLEY. We do have an ombudsman, but to the EGRPRA process, we have established a Web page on the Federal Financial Institutions Examination Council (FFIEC) Web site that hosts all of the information about the EGRPRA process.

So each of the Federal Register notices seeking comment on rules is there. Institutions can submit a comment through the Web site. Institutions can watch the public meetings in a live Web cast. And it is just all there.

And we encourage institutions to take a look at that and actively participate. We do find it most helpful when institutions give us specific information about how rules are impacting them.

Mr. CLAY. Thank you.

Ms. Hunter?

Ms. HUNTER. I would only add that we do take the EGRPRA process very seriously. Any institution, really, any one in the public can comment on rules and regulations through that process.

I would also encourage bankers to attend the sessions. We have one coming up in May in Boston, on May 4th. And all of the information about registering for those sessions is on the Web site that Ms. Eberley referenced.

Mr. CLAY. Thank you.

Mr. Bland?

Mr. BLAND. Ranking Member Clay, in addition to EGRPRA, I would talk about a few other things.

Through our examiners, we have dedicated examiners for each institution. And so, in addition to the exam process, they are available to institutions throughout the year to be available to field questions. Supporting that examiner are a number of subject matter experts that we make available to bankers to help them work through these issues and concerns.

We have a very robust outreach program where we bring together bankers to talk about issues of concern and guidance. We put out periodic issuances to them explaining the information that is most useful to them.

In addition, we also have a mutual advisory committee that meets regularly so we can discuss their concerns. We also have a minority depository advisory committee where we get to hear issues and concerns of minority bankers as well.

We issue quarterly guidance or rules that have come out along with quick simple explanations to community banks as well.

Mr. CLAY. Thank you.

Mr. Fazio?

Mr. FAZIO. Thank you. We actually have an office called the Office of Small Credit Union Initiatives, that is specifically dedicated to reaching out to smaller credit unions. We do training. We administer grant programs authorized by Congress.

And so, there is a particular connection to that office. They also do a lot of online training in addition to physical town halls. Our chairman and the NCUA Board also hold various town hall meetings throughout the year. We do an online call, webinar, interactive webinar, with credit unions quarterly as a method of outreach.

And we also attend various other events that are hosted by the credit union trades and leagues, that often have special aspects of those events dedicated to small institutions.

And so, we are actively reaching out to small institutions to hear what they have to say about the challenges that they face.

Mr. CLAY. Thank you.

Mr. Silberman?

Mr. SILBERMAN. Thank you. We have a number of vehicles, Congressman Clay. We have established a community bankers advisory committee and a credit union advisory committee, which meet regularly to provide us with advice.

We have established an Office of Financial Institutions and Business Liaison, which is an access point into the Bureau and also out from the Bureau.

Just recently, for example, that office had a conversation with a community banker in a committee member's district as a follow up to the Director's testimony here.

We also have regular field hearings most months in which we go out into different communities. In each field hearing, there is always a community banker or credit union participant. But in addition, we make it a point to have a separate meeting with community bankers in the city which we are in, and a meeting with credit union representatives in the city which we are in, so we can hear not just people who come to Washington, but we go out to them. These are all ways in which we get input.

Mr. CLAY. Thank you.

Anything to add, Mr. Cooper?

Mr. COOPER. In addition, as mentioned, the State regulators in CSBS conduct, with the Federal Reserve, an annual community bank symposium. This includes town hall meetings with all of our banks.

We put out a survey asking for issues—what are the current issues? What are the questions? What do we need to do? And these are compiled. Last year, we had over 1,000 banks participate in the survey, and the survey is ongoing as we speak right now.

Mr. CLAY. Thank you so much. My time—

Mr. PEARCE [presiding]. The gentleman's time has expired.

The Chair now recognizes himself for 5 minutes.

Mr. Silberman, you heard the chairman's opening remarks about the number of community banks that have closed in the last several years. Is that ever a topic of discussion at the CFPB? Do you all wonder about that? Do you think it is good or bad?

Mr. SILBERMAN. Absolutely. The Office of Research, which reports to me regularly, is studying that. We monitor it. We think it is a—obviously, a long-term trend, as I am sure you know, that goes back at least to the 1980s or 1990s. And it has been continuing, but it is something we would like to—we believe deeply in the diversified—

Mr. PEARCE. You haven't looked at the impact of your regulations on that?

Mr. SILBERMAN. I'm sorry—

Mr. PEARCE. Do you ever look at the impact of the regulations coming out of your agency on that?

Mr. SILBERMAN. Yes, certainly, that is something we will be carefully looking at as—

Mr. PEARCE. Are you ever critical of the processes that you have set up?

Mr. SILBERMAN. We—I didn't—

Mr. PEARCE. You don't ever find any fault inside the agency? It is mostly just this long-term trend you are describing?

Mr. SILBERMAN. No, Congressman, I said that we are carefully studying this. It is very early to know the effect of the rules. Most of them have been in effect for a little over a year.

Mr. PEARCE. It is not very early for the people out there. They can tell me almost by the minute. So you never listen to those comments? You don't ever take those comments and say, "Well, those guys are just stretching it" or "They are correct?" I don't know—do you ever evaluate that kind of thing?

Mr. SILBERMAN. We are doing that on a continuous basis.

Mr. PEARCE. Okay. I just didn't get that idea when you said it is too early to assess. Because they know the assessment very early.

Ms. Hunter, in your testimony, on page 9, you talk about the compliance reviews. When you send your examiners out, do they spend the time on compliance or safety and soundness? Which gets the greater attention?

Ms. HUNTER. We actually have a dedicated staff for consumer compliance examination, so they are specialists who have expertise—

Mr. PEARCE. Which gets greater attention? If you are given a certain time in the bank, which gets greater attention?

Ms. HUNTER. If we look at the amount of time that they spend on the exams, the safety and soundness time on examinations would outweigh the—

Mr. PEARCE. Is that what the—

Ms. HUNTER. —time dedicated to—

Mr. PEARCE. — do you get that confirmation from the banks?

Ms. HUNTER. We—

Mr. PEARCE. Because the banks tell me—the banking industry in New Mexico is not that large, so we don't spend a large amount of our time. But every time I gather them, they say the safety and soundness is this much, and now compliance is this much. That is the reason that many of the lenders have gotten out of the real estate market.

They tell me that if they misplace a comma now, they could be facing a $10,000 fine or a $50,000 fine. They said it used to be that they would take care of it. The examiner would bring it to them and say, "You need to put a comma in here." And now, they say for a $50,000 fine, that is more than what they will make on a $30,000 loan for a house. Do you ever get those kind of comments? Or do they just kind of pick at me while I am out there and—a friendly audience sort of deal?

Ms. HUNTER. We do get regular feedback about the examination process.

Mr. PEARCE. But have you ever heard that exact thing?

Ms. HUNTER. I haven't heard about those comments, but I would say—

Mr. PEARCE. I will tell you what—if you give me your home phone number, I will put them in touch with you. It is—

Ms. HUNTER. I would welcome having an opportunity to talk to anyone who had an issue raised about that.

Mr. PEARCE. I hear it pretty frequently. I will start referring them to you since it doesn't seem to be anything that maybe has come up.

You say that something you want to do is encourage the flow of credit to consumers. Now, with the number of community banks closing—and they regularly tell me that we just can't keep up with the regulations—so I would suspect all of you would have that as an outcome that you would like to have.

So, almost the same question that I asked Mr. Silberman, do you sit as an agency and say, "Hey, we are starting to restrict the flow of access of capital to the small rural markets?" Is that a concern to you all? Because I guarantee it, nobody from New York City is going to come out and make loans on trailer houses in the 2nd District of New Mexico. So when those small places shut down, they are shut down.

Ms. HUNTER. We are very concerned about flow of credit and access to credit in any community or to populations or groups who might be underserved. And there is a direct connection between the access to financial services with that. That is certainly something I have seen in my own experience as a community bank examiner.

So when we hear from bankers—and we do—

Mr. PEARCE. Okay, so—

Ms. HUNTER. —we hear the same things. We hear—

Mr. PEARCE. —let me bring up—I only have 27 seconds left, and the chairman is not as forgiving to me as he is to himself, so—the CFPB has rules on rural. And they put Deming, New Mexico, which has about one person per 10 square miles in the same category as New York City. Did you all send communications to them saying, "We are alarmed because you are restricting flow out in those rural areas that you have described as urban, and they are not really urban?" Did you all send a communication like that?

Ms. HUNTER. To be honest, I don't know 100 percent exactly—

Mr. PEARCE. Could you check that out for me?

Ms. HUNTER. —communication. I would be happy to get back to you—

Mr. PEARCE. I would like to see a written trail—

Ms. HUNTER. —with information about it.

Mr. PEARCE. —if you are really concerned about that.

Ms. HUNTER. Yes.

Mr. PEARCE. Okay, thanks. The chairman's time has expired.

And we go next to Mr. Hinojosa from Texas.

Mr. HINOJOSA. Thank you.

I want to thank both of you for holding this hearing this morning. And I would like to thank the distinguished panel members for sharing their insights.

It seems to me that the proper regulation and supervision of our banks requires a balancing act to ensure both the stability of our financial system and that of banks, like our community banks, which did not cause the financial crisis, but are unduly burdened by regulation.

I am going to ask my first question to Toney Bland, as well as Doreen Eberley and Maryann Hunter.

Each of your agencies has expended a lot of time and resources in developing targeted regulatory relief for community banks. How

are asset thresholds helpful or harmful in: one, ensuring the safety and soundness of our community banks; and two, providing flexibility in the regulatory framework so as to not unduly burden community banks?

Mr. BLAND. Representative Hinojosa, the asset thresholds are merely an indicator for a cluster of institutions that may have similar characteristics. For example, 80 percent of the institutions that we supervise are less than $1 billion in assets. And so when you look at that grouping of banks, you see some characteristics in terms of they are locally owned, locally operated. But that is just the beginning. You also have to look and see what their market place is like, what is the complexity of their operations, what type of staff they have, the ability of the staff, the size of the staff, and the operations of the institution. Are they pretty much brick and mortar, or are they involved in Internet-type activities?

So, the thresholds are a pointer. Where it gets challenging, though, is when that becomes the only reference to what a bank can or cannot do just based on size. That is where the issue comes in. So we would be wary of rules that would limit the flexibility and that would be counter to safety and soundness or consumer protection safeguards.

Mr. HINOJOSA. Thank you.

Ms. Eberley?

Ms. EBERLEY. Thank you. I would agree. We use a definition for community banks that is focused on the characteristics of the institution, so—

Mr. HINOJOSA. Could you speak up a little bit louder, please?

Ms. EBERLEY. Yes, certainly. We use a definition of community banks that is focused on the characteristics of the institution, so, similar to what Mr. Bland said. Local relationships, core deposit funded, a relatively small geographic area so that they are actually dealing with their customers face to face. They know their customers.

For us, that is 94 percent of institutions under $10 billion meet that definition and have those characteristics. It is harder to define that with an asset threshold. It is easier with the characteristics of the institution and the way that it operates.

I want to pick up on one thing that Mr. Bland said, which is flexibility. Where statutes have bright lines thresholds, it makes it a little bit more difficult for us to exercise flexibility. One example of that would be with stress testing. And so, we don't have a lot of discretion in how we apply the rules with the asset thresholds that are set.

Mr. HINOJOSA. Ms. Hunter?

Ms. HUNTER. Yes, I would agree. We also determine a definition of community banks. We do have a threshold of $10 billion. It is really more for the convenience of being able to identify the population of banks that fall into a certain group and how we manage our examination programs.

I will say that the vast majority of community banks are actually under $1 billion in assets. So in some sense, the $10 billion threshold is not where our primary focus is.

I do agree that hard line thresholds do limit flexibility. Yet, at the same time, it also can be difficult. Whenever you draw a line

and say a certain bank fits a certain category or doesn't, there is a lot of argument back and forth about who is right on the line in going over on the other side. So having a clear definition does help a little bit in just adding clarity to the group of banks and understanding where that line is drawn.

I would like to add one other comment, and that is, we have examiners in each of our 12 Reserve Banks, as the other agencies have them local. They understand these banks. And that is part of the local knowledge that the examination teams have about those institutions, their risks, their business model, their strategies, and the strength of their management teams. And so we do incorporate that into how we think about, how we supervise individual institutions.

Mr. HINOJOSA. My time has expired. I wish I had more time to ask some other questions.

With that, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now, the gentleman from Oklahoma, Mr. Lucas, is recognized for 5 minutes.

Mr. LUCAS. Thank you, Mr. Chairman.

I represent an area that relies heavily on community financial institutions, and they are very critical to our economic success, both in the district and the State. And I have been very focused with them on the regulatory relief that I think they desperately and rightly deserve.

And it seems like in a committee where we may not necessarily agree on a whole lot of things, I believe there is the potential amongst this group to come up with a way to provide some relief to those community banks.

Now, the key, of course, is how do you achieve a definition—a consensus on what a definition would be.

So I would like to follow on my good colleague from across the line in the great State of Texas's logic, and let's continue this discussion. Because right now, the way the system is working, my community banks are telling me that it is not working. I appreciate the flexibility that the Fed and the Comptroller and the FDIC have discussed today, but you are taking a very small screwdriver and you are making minor adjustments in a very complicated set of machinery.

My constituents believe that relief has to come if, as an industry, they are going to survive.

So, let's go back a little more into this definition concept. You have general definitions that have been alluded to—anything from $10 billion to a billion dollars; some quantitative qualities in some of your definitions. But let's talk for a moment. How do we come up with a definition that actually provides relief out there? Some of my folks believe it should be a dollar amount because they think that just as that adjustment can help, so those minor adjustments can hurt.

I appreciate the point made by Commissioner Cooper about the quantitative issues, but let's talk about that. How do we come up with a definition that provides some real relief to these community banks that we all know exist? How do we define those, ladies and gentlemen?

And I ask my friends at the Comptroller's office and my friends at the Fed and my friends at the FDIC your opinion. From my perspective, going $10 billion and then giving you quantitative adjustments makes sense. But from your perspective?

Mr. BLAND. I will start, Representative Lucas.

Mr. LUCAS. Please.

Mr. BLAND. I am out a lot. A big part of my job is talking to community bankers about the burdens that they face. This is a topic that comes up quite a bit. And it is not as simple as what a bank's size is because you also have to consider the business model. This is at the essence here, I think, for community banks, is what is the right business model, and to have the flexibility to exercise what is a good business model.

And the concern is when asset size is a condition of what you can or cannot do, that can have limitations when you are looking at innovation in the industry. And so, my point on flexibility earlier was that you have to allow for innovation.

Typically when there is a size, there are also conditions on what that size can do. And I think that is what is happening in the industry today. We have to be open to the changes that are happening in the bank and the non-bank space to allow for that innovation and growth to occur.

Ms. EBERLEY. I would echo that. And that was the point I was trying to make in my last answer, that having a strict asset threshold without having any flexibility around that makes it difficult. It limits our ability to exercise discretion on a risk-based basis, which is how we approach our supervision.

So we look at the risk of an individual institution before we start an examination. There is pre-exam planning that looks at what is the institution engaged in. The examination activities are focused on the activities of the institution, as opposed to a one-size-fits-all.

Mr. LUCAS. But it almost appears in the way the rules work right now, by the general definitions of all three organizations, if your institution is $11 billion, but in every other way meets a definition that—whatever that consensus might be that it is a community bank, they are still snagged in everything. They are trapped.

My perspective is I believe in giving you the flexibility, yes, to do what you need, but when a community bank still gets caught—a dollar, a billion dollars, whatever—over the limit, then they are snagged. Those are the kind of issues I think that we are trying to work our way through.

Mr. Cooper, for just a moment, the only person quoted almost as often in this committee as Phil Gramm is former Fed Chairman Volcker. And recently, he came up with a concept about how to dramatically redo regulation. Could you expand for a moment, from a State regulator's perspective, about this concept of dramatically changing how we do our regulatory regime?

Mr. COOPER. Congressman Lucas, first let me say that the Volcker proposal is still—we are evaluating it as we speak. We had a couple of takeaways we came away with recently.

We are here talking about what to do about regulatory burden, and we don't think that proposal necessarily helps us in that regard. Up-ending the system we have creates problems in and of itself. It creates a new monolithic regulator, and we believe that

could possibly move us toward more of one-size-fits-all rather than less. And also it gives the Federal Reserve, whom we do support in bank supervision, quite a bit of authority that we feel like may be too much for one individual agency.

Mr. LUCAS. Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very much.

This is a very interesting hearing, very helpful.

I want to start off where Mr. Lucas and Mr. Hinojosa left off, because I think that is a problem. And you can't really solve a problem until you define it. We have community banks. We have regional banks. Then we have too-big-to-fail banks.

In other words, we have these titles, but we don't have the definition? You don't define—you can't get your hands around the problem if you don't adequately define it. And do you define it by size or complexity?

Now, I think that was a part of the root of the problem that we had in Georgia. As many of you know, Georgia led the Nation in bank closures. And my good friend from Georgia, Mr. Lynn Westmoreland and I, pulled together a big event down in Georgia where we brought the Federal Reserve, and I think some of you all know about that. We brought in the FDIC, the OCC, and all of the bank examiners to find out why in the world—what happened that my State of Georgia led the Nation in bank closings over 4 or 5 years during the mortgage breakdown.

Are you all familiar with that?

I want to know what happened there. Lynn and I consistently complained that we have not gotten reports on it. So I want to know if you all can respond to that now, if you are familiar with it perhaps. But your bank regulators were there.

Now, part of the problem was indeed that our Georgia banks, as many banks did, did overleverage in their portfolios in terms of real estate and mortgages, as did the whole country, as did the whole industry. But something strange happened down there. And we discovered that when you all came down there, and we had the big hearing.

Lynn and I together cover about 25 or 26 different counties. And in these areas, it is the community banks that are the lifeblood of those communities. So unless we define community banks, unless we can come up with those reasons, we really are not getting our hands around it.

So I just want to say, do any of you have any comments? Are you familiar with that report? What happened? I would like to know what the impact was.

Our banks were saying the bank examiners didn't give them time. They weren't aware. They were overregulated. They didn't understand the complexity of the rules. So there was some blame put at the feet of the FDIC, the Office of the Comptroller of the Currency, and the Federal Reserve as to what happened.

Are you all familiar with what happened in Georgia?

Ms. EBERLEY. Yes. I will start. One of the problems with the financial institutions in Georgia is that as a group they were heavily

concentrated in acquisition, development, and construction lending. When the real estate market took a turn and mortgages and property values dropped dramatically, projects that were midstream became difficult to finish because there was nobody to buy the finished product. The values had dropped. And that kind of concentration and saturation in a very tight market of that kind of product in that kind of market environment is largely what caused the problem.

Mr. SCOTT. All right. I would just like to ask—I know we have a representative of the Federal Reserve here and we have a representative of the FDIC and we have a representative of the Office of the Comptroller of the Currency.

I am sure both my colleague Lynn Westmoreland and I would love to get that report as to what is going on there. As I said before, the community banks are the life blood there. They are sort of in the middle.

So Mr. Bland, I want to go back to you. How would you define right now, if somebody had to ask you right now, in the 25 seconds I have left, what is a community bank, what would you say?

Mr. BLAND. My first response would be that community banks tend to be locally owned and locally operated. But I will go back to what I said before about where we stand in this industry today and looking forward with the innovation that is happening in there. They can also be characterized by the scale and the type of products that they offer. But to your point about how we would approach it, I think it is important to look at our supervisory process. At the OCC, we have a separate community bank program that I oversee. And so our primary focus for the people who report to me is on community banks.

We look at those institutions separate and apart from the large banks. This also guides our approaches to our policies and our procedures. And for each institution, we take a customized view of what we need to do there, so we have a supervisory strategy that is focused on each individual institution.

Mr. SCOTT. Thank you very much.

Mr. Chairman, I would just like to say that it might be helpful for the full committee—it was a very good hearing down there. If we would ask the OCC, the Federal Reserve, and the FDIC if they would get that report in their findings, conclusions, and recommendations of what they did in Georgia at our hearing, I would appreciate it.

Chairman NEUGEBAUER. I think that message, hopefully, has been delivered today, Mr. Scott.

Mr. SCOTT. All right. Thank you.

Chairman NEUGEBAUER. I now turn to the gentleman from North Carolina, Mr. Pittenger, for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Mr. Silberman, how is a Consumer Financial Protection Bureau funded?

Mr. SILBERMAN. Under the statute, we receive a percentage of the revenue of the Federal Reserve System.

Mr. PITTENGER. Yes, sir. So you are not funded through the budget. When you need money, you call the Fed and they send you a check. Is that it?

Mr. SILBERMAN. There is a certain cap. But up to the cap, we have a claim on money from the Federal Reserve.

Mr. PITTENGER. Yes, sir. How much is that cap annually?

Mr. SILBERMAN. I would have to get back to you. I'm sorry. That is not my area of expertise.

Mr. PITTENGER. About maybe $600 million—

Mr. SILBERMAN. I was going to say $500 million, $550 million but I am not—

Mr. PITTENGER. $650 million—

Mr. SILBERMAN. But I think we should get back to you. But I would—if I had to—it would be $550 million, but I am not sure that is right.

Mr. PITTENGER. Okay. Thank you for that. You stated that you would like to see reform in the system. You are responsive to businesses, you are responsive to banking stress systems that are out there with—that do not allow the access of capital in the market. Is that correct?

Mr. SILBERMAN. Our focus is on consumer protection, not on safety and soundness. But certainly, those are two sides of the same coin.

Mr. PITTENGER. Yes, they are. We passed a bill yesterday that would establish an advisory board for small businesses and allow that board to have a voice. Now you mention that you do go out in the market and you talk to people and you are listening. But there is no requirement for the credit unions, for you to meet with them or you can voluntarily, if you so choose. And of course, there isn't a position to this point on the CFPB for the voice of small business and that was the interest of this bill yesterday.

There was a cost that was set up for this board that was about $100,000 a year—a pretty nominal amount of money, I think, for having the necessary input from this important element. We are in an economy right now that is struggling. It is going to 2.2 percent. We have 20 million people who are underemployed or unemployed. And you now, much needs to be done to get us to the desired objective. And certainly, as we have all heard today, community banks, smaller banks, and institutions of all sizes are important to help us address economic growth and the access to capital. Do you think it is a viable concern that we have a voice from the business community on the CFPB?

Mr. SILBERMAN. Congressman, the Bureau tries not to comment on pending legislation. And so really, all I can say on that is that we have been very careful to make sure that we have, as I indicated a Community Bank Advisory Committee, a Credit Union Advisory Committee, an Office of Financial Institutions and Business Liaison. We have a Consumer Advisory Board, which is a very diverse—

Mr. PITTENGER. But you don't have one that is specifically related to the input of business. Do you believe that this amount of $9 million over the course of 10 years is really negligible, as it relates to the ability for CFPB to draw down $670 billion a year? A sizable amount of money has been spent just on your renovation, so far, $200 million for waterfalls and glass staircases—more, I am told, than any hotel in Las Vegas.

This is an important element. But just in terms of the dollar ratios, do you think this is really just a negligible amount of money that really shouldn't be of consideration?

Mr. SILBERMAN. Congressman, as I said, we try not to comment on pending legislation. And certainly, that question will be better directed to the folks who are responsible for our finances than to me.

Mr. PITTENGER. Thank you for your input on that.

Ms. Eberley, I have had a number of comments from smaller banks in my region and I would just like to read you one very, very quickly. Here is one bank with less than $50 million in assets and 10 employees. They come in, they want 3 to 4 weeks advance to tell us the materials to forward to them. When we get started, they are on-site. The daily work that they put in is 8 to 10 examiners are there. They take 2 to 3 weeks.

These are institutions with less than $50 million. They said if any corrections are to be done, it takes several weeks or months to do this. And they said that they are spending a larger and larger amount of their time on compliance, and they can't meet the needs of their customers.

Is that a concern to you?

Chairman NEUGEBAUER. I am going to ask Ms. Eberley to respond to that question in writing because I think it is a more complex answer.

And I will now go to the gentlewoman from New York, Mrs. Maloney, for 5 minutes.

Mrs. MALONEY. Thank you, Mr. Chairman, Mr. Ranking Member, and all of the participants today.

Mr. Bland, I would like to ask you about the OCC's liquidity rule, and specifically about the treatment of municipal bonds in the so-called "liquidity buffer" that banks hold. As a former member of a city council, I know firsthand the importance of municipal bonds. They allow States and cities to finance infrastructure, build schools, and pave roads. They are incredibly important to city governments.

Unfortunately, in the liquidity rule, the OCC chose to include some corporate bonds in the liquidity buffer, but completely excluded municipal bonds. The OCC established liquidity metrics for corporate bonds so that if a corporate bond meets all the metrics, then it can be included in the liquidity buffer. But for some reason, the exact same deal was not extended to municipal bonds.

Now, it is my understanding that the Fed has already recognized this inconsistency and is working on a proposal to establish liquidity metrics for municipal bonds. But the OCC is still refusing to consider giving relief to even the most liquid municipal bonds. So my question, Mr. Bland—I would like you to consider two identical bonds, same size, same maturity, same everything. Both bonds are liquid enough to satisfy all of the liquidity metrics in the OCC's rule, but one bond was issued by a corporation and one was issued by a local government.

Under the OCC's rule, the corporate bond would be considered a high quality liquid asset. But the municipal bond wouldn't, even though they have the same exact liquidity. So, my question to you, Mr. Bland, is, do you think that is a fair outcome?

Mr. BLAND. Representative Maloney, first let me say we support institutions having a diversified portfolio of investments, including municipal securities. And it is important for banks to participate in the investment in municipalities for the purpose they serve—the support to local and State municipalities.

The question you raise pertains to the liquidity coverage ratio, which our largest institutions are subject to, and not our community banks. The rule addresses asset classes, and does not look at individual issuances. And so as an asset class, our experience and the data we have suggests that when stressed, municipal securities do not have the secondary market that corporate securities would have. And so the issue is around the class of assets, not an individual issuance of any kind, but more our experience by looking at this category of type of investment.

Mrs. MALONEY. Okay. I would like to ask Mr. Cooper, and I notice that Texas signed onto a 43-State investigation that wrapped up last week which imposed a $5 million fine on New Day Financial, a lender that targets veterans for mortgage loans. And the settlement agreement concluded that New Day violated MLS rules of conduct by teaching to the SAFE's test.

They had at least 20 employees take the SAFE Act course on behalf of others. This was a complete lie, and including the CEO and COO, and lied to investigators about their knowledge of these actions, all in connection with New Day providing SAFE Act courses in-house to their own employees.

And I have been warning about this practice of in-house SAFE Act courses for years. I have written many organizations about how it is a conflict of interest, and others on this committee, including Ranking Member Clay, have also warned the CSBS about this practice, but CSBS hasn't done anything so far about this. And it appears that New Day is allowed to continue to provide these SAFE Act courses in-house.

So Mr. Cooper, my question is, will you commit to having CSBS brief me, my staff, and other members of this committee, Mr. Clay and others, and anyone who is interested, on this investigation? And explain what CSBS is doing in response to what is a big scandal?

Mr. COOPER. Certainly, Congresswoman. We will do that. I will tell you that the announcement of the settlement is a process that the States went through through the multi-State mortgage committee that we have in order to try to deal with issues like this. We do think it sends a message. But we will certainly look into—

Mrs. MALONEY. Thank you. I have 4 seconds left, and I wanted to ask Ms. Hunter the same thing on the liquidity metrics. Mr. Bland, if you could get back to me in writing, I would appreciate it. I saw in an article today in The Wall Street Journal that you are moving on it. Thank you.

Chairman NEUGEBAUER. I now recognize the gentleman from New Hampshire, Mr. Guinta, for 5 minutes.

Mr. GUINTA. Thank you, Mr. Chairman.

I want to thank the panel for your testimony and your willingness to come today. I am going to make a brief statement, and then I wanted to ask Ms. Eberley a few questions.

Community financial institutions have testified multiple times before our committee that they have not caused or been the root cause of the financial crisis, but that they are being burdened by regulatory requirements as if it were the case.

And that is a concern of mine. New Hampshire is a small State, 1.3 million people. We have a rather significant community of financial institutions, small lending community financial institutions in our State. And I have over the course of the last several years had the pleasure of meeting and spending time with many of them. And I think they do a great job, whether they are credit unions or small community banks.

But after a lot of the discussions that I have had with CEOs, presidents, and executive teams of these institutions, I am actually very discouraged and remain discouraged by some of the things that I have been hearing relative to the regulatory burdens. This is the single issue that I hear about from institutions in New Hampshire more than any other issue.

So, I have brought up in previous committee hearings some examples of these particular challenges. And I was a little surprised to hear Richard Cordray be shocked that these small institutions were being burdened. So, he was kind enough to have someone in his organization call a specific bank president that I had asked them to call, Piscataqua Savings Bank. And I will get into the statistics in a minute.

But Ms. Eberley, I wanted to know from your experience in regulating these institutions, would you say that it is more difficult for an institution, a small institution, to comply with the new regulatory mandates than the larger institutions?

Ms. EBERLEY. In general, it costs more. The cost of complying with laws for smaller institutions is spread over a smaller asset base, so it costs them more.

Mr. GUINTA. So the economies of scale—

Ms. EBERLEY. Right.

Mr. GUINTA. —is much easier for a larger institution than a smaller institution?

Ms. EBERLEY. Yes.

Do you think that the number of regulatory changes negatively affected a community financial institution's ability to offer products and services to the consumer?

Ms. EBERLEY. I don't think so. I think we are seeing community institutions offer a wide variety of products. And I would just note that New Hampshire is home to the latest application for deposit insurance, approved by the FDIC in March.

Mr. GUINTA. How many have there been in the last 5 years in our country?

Ms. EBERLEY. I can't go back 5 years, I apologize, but we had the bank in New Hampshire in March of this year. The prior one was an institution in Pennsylvania in 2012. Those are the two since—

Mr. GUINTA. So it is less than 5 in the last 5 years?

Ms. EBERLEY. —the crisis, the end of the crisis.

Mr. GUINTA. Would it be fair to say it is less than five in the last 5 years? New institutions—

Ms. EBERLEY. I would have to go back to 2010, I apologize.

Mr. GUINTA. I would submit that I think it is probably less than 5 new institutions in the entire United States over the last 5 years.

And that is a concern of mine. I am very proud of the fact that we have a new institution in New Hampshire. It is going to be a primary bank, a great institution. And I am very proud that it is in New Hampshire.

What I am very concerned about is that there are only a few in the entire country. And the entire market is actually shrinking.

That brings me back to your testimony—93 percent of all banks in the United States are defined as community banks, and your testimony says that they hold just 13 percent of bank assets, yet 45 percent of the small loans to businesses come from those institutions.

So it concerns me greatly when I look at Piscataqua Bank in Portsmouth, New Hampshire. And let me just read you these numbers. Compliance costs, wages and benefits, $772,000 go toward compliance costs. Seminars and webinars, $11,915. Subscriptions, $38,747. For a total cost for this one bank for compliance of $823,278. That is 22.76 percent of their overall costs.

So they have FTEs, about 38. For compliance, they have eight.

That seems rather unfair and unnecessary. Assuming that those figures are correct, does that make sense to you, that it is unfair and unnecessary.

Ms. EBERLEY. I would have to evaluate that.

Chairman NEUGEBAUER. The time of the gentleman has expired.

The gentleman from Massachusetts, Mr. Lynch, is recognized.

Mr. LYNCH. Thank you, Mr. Chairman.

I have listened to the debate here, and it has been very, very instructive. We all seem to struggle with this definition of community banks that weren't part of the problem during the crisis in 2008 and beyond and the banks that needed regulation.

There is a great article from this past Sunday by Gretchen Morgenson, who is a continual source of wisdom on these matters. It is entitled, "Regulatory Relief for Banks That Really Fail."

And she talks about a proposal by Tom Hoenig, who is a Vice Chair over at the FDIC. He has a very simple plan, and it addresses the concerns of the gentlemen from New Mexico and Oklahoma and Georgia.

He comes up with four criteria that, really based on the complexity of the bank, based on the risky behavior that they have, the regulatory framework falls more heavily on those, but frees up the regulatory framework for banks that—for local community banks that don't engage in risky behavior.

And, quite simply, I will just tell you what they are. He says that banks that hold no trading assets and/or liabilities; banks that have no derivatives positions other than plain vanilla interest rate swaps or foreign exchange derivatives that get traded up front, there is no looming deadline there, no leverage; finally, banks whose notional value of all derivative exposure is less than $3 billion; and fourth, banks whose shareholder equity or net worth is at least 10 percent of assets.

Now, when you apply that criteria to commercial banks, out of 6,500 commercial banks in this country, only 400 are covered under the regulations, so 6,100 are exempt, basically.

Or when you look at the complexity of banks, the great majority of the banks that we are talking about are traditional banks. And so, he also talks about the relief we could offer them. He talks about the fact, Ms. Eberley and Ms. Hunter, that we could stretch out the examination period for non-risky banks, community banks, from every 12 months to every 18 months, so you are only doing 2 examinations every 3 years, instead of 3 examinations.

He talks about the relief under the Basel capital standards. We could exempt a whole lot of our banks from that standard.

He identifies 18 banks with total assets of $10 billion that would also qualify. So it is not just small banks, it is big banks that don't do risky things, that would be helped by his proposal as well.

He also talks abut the fact that in these simple cases for community banks, the FDIC and other regulators could do the stress test themselves, rather than requiring our local banks to engage in a very costly process.

And, as far as that 10 percent of net worth to assets, the vast majority of our community banks, banks that you oversee, are already in compliance. And a bunch of others are right on the bubble; they could get into compliance if they chose to do so.

And Tom Hoenig is someone who is concerned with the stability of our banks and making sure that banks are sound. And so, I have actually asked my staff, and we are in the process of putting together legislation that would comply with all that.

Ms. Eberley, what do you think about that? Without the benefit of having read his proposal, of course.

Ms. EBERLEY. The vice chairman's proposal does suggest a risk-based approach to regulation, and that aligns with the approach that we already take to risk-based supervision, risk-based assessments for our deposit insurance pricing, and risk-based regulation and guidance.

So I think it is consistent. I think it is a policy call for Congress. I think we have already indicated a willingness to talk about a simpler capital approach for community banks.

Mr. LYNCH. Great.

Ms. EBERLEY. The definition we use of community banks does incorporate some institutions over $10 billion, by using—we have a different way of applying kind of the risk chacterizations—

Mr. LYNCH. Okay. I want to give Ms. Hunter a crack at this as well.

Ms. Hunter?

Ms. HUNTER. I agree with all the comments that Ms. Eberley made in terms of the risk-based approach.

I would add that at the Federal Reserve, we are considering how the agencies might be able to do some simplification consistent with the Collins Amendment and other sound prudential practices, particularly with respect to the capital proposals that were put forth. But I haven't studied the whole proposal.

Mr. LYNCH. In closing, I just want to say that the gentleman from New Mexico pointed this out, as well as the gentleman from Oklahoma, that this regulatory burden is causing consolidation. It is squeezing—it is forcing banks to merge, and putting some of our community banks out of business.

So we have to figure out a solution here. And I think that, with all due respect, Mr. Hoenig's proposal, in trying to define where that line is drawn, is one of the best proposals that I have seen.

And I yield back the balance of my time.

Chairman NEUGEBAUER. I think the gentleman.

And the gentleman from South Carolina, Mr. Mulvaney, is recognized for 5 minutes.

Mr. MULVANEY. I thank the chairman.

Mr. Fazio, I will begin with you, very quickly. Up until about 2009, you all used to have meetings with the credit unions that you oversee, regarding your budget.

You stopped doing that in 2009. Why?

Mr. FAZIO. Chairman Matz felt that it gave an appearance of regulatory capture and that there wasn't anything productive that was coming out of the briefing.

We have a very transparent process related to our budget. We post a lot of information on our Web site. We do discuss the budget at the open Board meeting when the Board acts on it. Credit unions and their representatives are free at any time throughout the year to give—

Mr. MULVANEY. Mr. Fazio, would you agree with me that there is a difference between what we are doing here today, face to face, and posting something on the Internet?

Mr. FAZIO. Sure.

Mr. MULVANEY. And this is a much more interactive and possibly more productive way to spend time?

Mr. FAZIO. Sure.

Mr. MULVANEY. And I would hope that folks on both sides of the aisle would agree with me that sometimes sitting down and having that face-to-face meeting is important. It is sometimes uncomfortable, there is no question about that. But we do it. And we ask you to come here and do it with us. And I think that it is reasonable for us to expect you to do it with the credit unions that you oversee.

Have you all decided whether or not you are going to have a budget meeting for 2016 with the credit unions you oversee?

Mr. FAZIO. I am not aware of a Board decision on that matter.

Mr. MULVANEY. When would they make a decision on that, Mr. Fazio?

Mr. FAZIO. Sometime this year.

Mr. MULVANEY. Finally, and this sort of may give you some insight as to why I care about this type of thing, it has been a year now since I asked for an answer to that specific question, as to why they didn't do, not only the meeting, but why they didn't provide line-item information in the budget.

Once you actually produce the budget, you don't give the credit unions line item details on your budget, and we asked why you did that and whether or not you would provide to Congress the line items in your budget. That was on April 8th of 2014. So I very much would appreciate a follow up on that, sometime soon, maybe just in the next 9 months would be great.

But waiting a year for that information, sir, when Congress asks you for what I think everybody would agree is a reasonable request, probably won't be tolerated very much longer.

So I appreciate your looking into that immediately when you get back.

Mr. Silberman, we will move to you now, very briefly.

I read your testimony. I also heard you say, when you came in today, a couple of different things. And you used really good language, language that we would expect you to use and, of course, that everybody uses, because it is easy to use language, but it is harder to follow up. You say that your approach on rules and regulations is tailored and balanced. That you are mindful of the impact of compliance on financial institutions. You engage in rigorous evaluation of the effects of proposed and existing regulations on consumers and financial institution, and you maintain a steady dialogue with both consumer advocates and industry participants.

I think later on you talked about an evidence-based process that you undertake.

Again, it is easy to use the words.

Last month we had some folks testify before this committee. Dennis Shaul, who is a CEO of the Community Financial Services Association, testified before this committee regarding a recent report that you all just put out on what a lot of people refer to as payday lending.

And in that report that you folks created, it estimated that roughly 60 percent to 70 percent of small payday lenders would go out of business as a result of your rules and regulations. That didn't seem to be disputed at that hearing.

So my question to you, sir, is, what evidence-based process did you go through? What balancing did you do? What data do you have that says it is in the best interests of consumers to drive 70 percent of these players out of the market?

Mr. SILBERMAN. Thank you for the question, Congressman.

First, let me begin, the process we have gone through began 3 years ago with a series of field hearings we have held. We have obtained I think the largest data-set of loan level—

Mr. MULVANEY. Great. Can I have that, please?

Mr. SILBERMAN. I will have to take that request back. This is supervisory data that we have obtained, so it is confidential.

Mr. MULVANEY. Why can't Congress have the same data you all are using for making your decisions?

Mr. SILBERMAN. It is confidential supervisory information, but I will have to get back to you on that.

Mr. MULVANEY. Please do. I have news for you. We get confidential briefings all the time. In fact, we have a special room downstairs for it. And to the extent the data on that rises to the same level as the threat of nuclear intervention in Iran, then I can ensure you your data will be safe.

But please continue.

Mr. SILBERMAN. Okay. And I believe, Congressman, we have actually provided briefings on the data to staff. We have published two reports on payday loans, one in 2013 and one in 2014, based on that data. We have also reviewed all the research. We have gone through an extensive process.

It is not the case that what we have said is that we would—we have started a rulemaking process. We have announced proposals that we are considering making. We are early in that process. But

it is not the case that we have said that proposal, if it were to become a final rule, would put 60 or 75 percent of payday lenders out of business. That is a misinterpretation of the document that we released.

Mr. MULVANEY. What is the correct interpretation of that document, Mr. Silberman?

Mr. SILBERMAN. The correct interpretation, Congressman, is what we said is that if current—if the business model continued as is, and payday lenders continued to do exactly what they have been doing, but capped the number of loans they give to people at no more than 6 loans per customer per year, so that is 90 days of indebtedness, that from that line of business, they would lose 60 percent of the revenue, which is to say that 60 percent of the revenue they are receiving comes from making more than 6 loans to consumers. That is precisely the issue we are trying to get at through the proposal.

Chairman NEUGEBAUER. Thank you, Mr. Silberman.

Mr. MULVANEY. Thank you, Mr. Chairman, for your accommodation of the extra time, but it may be that we need to have further investigation into that specific matter. Thank you.

Chairman NEUGEBAUER. The gentleman from Massachusetts, Mr. Capuano, is recognized for 5 minutes.

I will mention that votes have been called. And without any—I ask unanimous consent that the Chair will call for a recess here shortly, and then we will reconvene right after votes.

And with that, the gentleman from Massachusetts is recognized for 5 minutes.

Mr. CAPUANO. Thank you, Mr. Chairman.

And I want to thank the panel. I also want to thank my colleagues. I have to tell you, I came to this meeting not sure I was going to stay very long. To be perfectly honest, I thought it was going to be the typical bashing of regulators: "We hate all regulation."

This has been great. This is the kind of hearing I love, and I appreciate the chairman calling this, and the ranking member and all the panelists. I have learned a lot. I have listened a lot. And I have to tell you, I get amazed when I agree with pretty much everything that has been said. That is a pretty good day—not everything, Mick.

[laughter]

But pretty much everything. So I just, really, that is where I want to go. I want to associate myself with the comments made by all of my colleagues, especially Mrs. Maloney, relative to the municipal bonds. The OCC really has to wake up. Municipal bonds are the safest investments in the country. And if any bank can't invest in them because some regulator says that they don't hit some obscene, obscure, ridiculous little thing, that is nonsense.

It is the—there are some municipal bonds that may not meet that safety requirement, but there are very few. Particularly, it is going to hurt municipal governments. It is going to hurt local governments all across this country to tell any bank that they can't invest in the safest thing they can. It is completely wrong. And I have to tell you, the Fed is kind of moving on it. If the OCC doesn't

move on it, you are going to hear a lot more from us relative to that.

I don't expect a comment. You guys can look at it all day long.

Mr. BLAND. May I make a comment, though?

Mr. CAPUANO. You can, but if you come with the answer that you are not going to do it, you are going to be wrong. But go right ahead.

Mr. BLAND. First of all, we have not prohibited banks from investing in municipal securities.

Mr. CAPUANO. You haven't prohibited them, but you have discouraged them significantly.

Mr. BLAND. In fact, sir, the data hasn't shown that. Banks continue to invest—

Mr. CAPUANO. Not yet.

Mr. BLAND. —in municipal securities.

Mr. CAPUANO. You just did it. And you did it only a couple of weeks ago.

Mr. BLAND. And they continue to invest in these institutions and support their local communities.

Mr. CAPUANO. Well, good. Believe me, I would love to be wrong, and that is okay with me.

I also want to move on to some of the risk issues. My big concern when it comes to risk is that some of this stuff is so complicated you end up with the result that small banks especially can't figure out when they are into a risky situation or not.

And as you come up with these data points as to what is and what is not risky, which again I think the discussion has been great today, exactly where the line is and where it isn't, I think it is really important that you make the calculation of risk easy enough for a relatively small community bank to make the determination that they are getting into an area that is going to require more regulation and more oversight. Or to make the decision not to do it.

In the past, some regulators have told me, "We are a little concerned about people gaming the regulations." So what? If they game them to not be regulated, that means they are not doing risky things, which is a good thing.

I guess the last thing I want to do is I want to talk about the QM rules. I would argue that the best thing you can do for a community bank, and actually I think it fits under the definition I have heard everybody say, is to encourage community banks to actually be involved in the community. You are involved in the community when you have risk involved with the community, namely holding mortgages, holding loans.

And I would argue very clearly that as we go on, especially to the CFPB, that QM rules and any other rule not only allows small community banks to hold local paper, but actually rewards them for doing so.

I want—and I will be honest; I have said it publicly before—all of my cash, which isn't much, but whatever I have, and all of my mortgages, to the best of my ability, to be in local banks because I like the idea that they know where my street is. They know where my neighborhood is. They know how much a house is val-

ued. Their kids are likely to go to school with my kids. And on and on and on.

But at the same time, if they can't do it, which for all intents and purposes they have been pushed out of it, especially residential mortgages, they can't be a community bank for long. And I would strongly encourage you to not just allow something, but to also encourage and reward community banks to actually be involved with the community so that we can have somebody to donate to the local Little League.

I don't really have a question, as I said. I didn't really come with questions. But what the heck, I had 5 minutes, I figured I would use it.

Chairman NEUGEBAUER. I thank the gentleman.

And now, we will stand in recess until right after votes. And we thank the panel for their indulgence.

[recess]

Chairman NEUGEBAUER. The subcommittee will come back to order.

And I now recognize the gentleman from Colorado, Mr. Tipton, for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

And thank you, panel, for taking the time to be here. Mr. Bland, I certainly appreciate your comments in regard to moving that threshold in terms of banks that are in good order, and to be able to move that up. I am very proud, with Ranking Member Clay, to be able to put forward some legislation to be able to achieve that.

I would actually like to be able to move into some of the small bank issues. And Mr. Bland, I might want to be able to address this to you first. Every community banker who visits our office right now, or testifies before this committee, come in and they express concerns about regulations being indiscriminately applied through rule, guidance or best practice to the entire industry, where in some cases regulation is actually intended for larger institutions.

As a regulator, do you take into account in determining what is going to be the appropriate regulation to be able to fit the size of a bank?

Mr. BLAND. Representative Tipton, during my discussions with bankers, I hear similar issues and concerns that you have raised. And from the OCC, we are very cognizant of that and we really take an approach that one-size-does-not-fit-all.

And so the approach we take is to look at the activity and whether or not community banks tend to be involved in that. So for example, we have issued the heightened standards rule that is for our largest institutions. Community banks are not subject to that. The supplemented capital rule was not intended for community banks as well.

And so what we take into account when we issue not only rules, but also guidance—we clearly state what is applicable to a community bank and what is not. And then that also translates into our examination processes as well, so that the procedures that drive our supervision of community banks are focused on community banks.

Our tailoring starts with our rules and goes through our examination process.

Mr. TIPTON. So, trying to be able to tailor regulations, to be able to meet—this brings up a point, because I wrote down comments.

Ms. Eberley, you had stated that you are "keenly aware" of regulations' impacts on small community banks.

Ms. Hunter, you stated that you "seek out and are listening to feedback on reducing the impacts of regulations and policies."

Mr. Bland: "reviewing duplicative review processes."

Mr. Silberman: "mindful and responsive to the impacts of regulations on financial institutions."

And we can go down the line, but the problem is this: We are continuing to see rules and regulations that are literally crushing the industry. I come from a small rural community in southwest Colorado. I just recently visited a community bank in Delta, Colorado, and they said they are about ready to give up, that they are no longer doing the banking business. They are complying with rules and regulations.

And the costs are enormous. When we go back to Mr. Guinta's comments, the bank in his State—22 percent in terms of the costs. So I guess my question is: Is there any collaboration in terms of trying to be able to streamline? Because we are talking about duplicative regulations. When I listen to the comments, I heard you saying the things I would love to be able to hear, but are we seeing this actually happen in practice? Because our institutions continue to see those costs go up.

Ms. Eberley, you had cited the stress test. We have Zions Bank, which is basically a collection of community banks, but a regional bank. Their stress test paperwork last year was 7,000 pages. This year, it was 12,000 pages. How is that paperwork reduction working out?

Ms. EBERLEY. The stress tests are one area where we didn't have a lot of discretion in the rule-writing process because of what was in the statute. And we would welcome more discretion. We have been able to use discretion, for example, in the enhanced prudential standards and the way we look at resolution planning. So we have tailored resolution plans for the smaller institutions versus the larger, with more significant expectations for the systemically important financial institutions.

But on stress tests, one of the important things I would tell you is that when we issued the guidance, we issued it jointly. And we put a statement together that we attached to it that said it did not apply to institutions under $10 billion. And we have continued to do that and put statements of applicability on every financial institution letter that we issue a rule.

Mr. TIPTON. I appreciate that. And given the concern that you have all expressed in terms of the impacts, particularly on community banks, do you find it of great concern that apparently only 60 percent of the Dodd-Frank rules are written and 40 percent are yet to come? Do we continue to see more piling on?

Ms. Hunter, feel free. You look like you—

Ms. HUNTER. While I was looking, we were over time. So that is why.

There are still rules to be written, but the vast majority of the rules that are in process really relate to firms over $50 billion in assets. So I would not anticipate that they would affect community banks in any material way.

Mr. TIPTON. I yield back, Mr. Chairman. Thank you.

Chairman NEUGEBAUER. The Chair now recognizes the gentleman from Washington, Mr. Heck, for 5 minutes.

Mr. HECK. Thank you very much, Mr. Chairman. Mr. Silberman, this is for you. I have been enormously privileged in my life to sit on both sides of this table. I am a former chief of staff to a governor, and agency directors were direct reports to me. So I have had to supervise and monitor the development of rules and regulations and their implementation.

But of course, I sit here now. And I am also a former State legislator, so I also know the world of proposing policy that then has to be implemented through the promulgation of rules and regulations. And I know the world of hearing back from people who are affected by those policies and implementing rules and regulations.

And I have come away with kind of a life-long point of view that what all of this is about is the very difficult and creative tension between clarity and flexibility, which are at odds so very often, right? Clarity, which we ask for all the time. Just tell us what the rules are, which leads to bright lines.

But at the same time, we all too often hear, where is the flexibility? Why can't this be more discrete as it relates to our personal circumstances? So you have this ongoing clarity versus flexibility tension in your world. And I think they are both equally important and valid.

And by analogy—eventually I am going to get to my question, I ensure you—there needs to be this magic balance between the inputs on the development of policy, anecdotes, and data. They are both valuable. I wouldn't want to try to develop policy at this level based purely on anecdotes, but I value them because they put a human face and a story to it. Nor would I want to be robotically tethered to data.

As it relates to QM, and you knew I would get to a question eventually, we are hearing a lot of anecdotes about how the QM rule is impacting financial institutions. And I think it is important to listen to those. Again, I don't think it ought to exclusively or purely drive our response, but it is important.

My question, sir, is, where is the best place to go to get the data? If there is an implementation issue out here that is causing problems, which we are given anecdotal evidence of, where is the best place to look at the data to help give context to those anecdotes?

Mr. SILBERMAN. Thank you, Congressman. It is a great question. And I think when it comes to QM and the mortgage market, there are multiple sources of data to be used in addition to, as you said, listening to the real stores and the voices. So HMDA is certainly a key source of data which provides insight into the number of loans, number of loans by size and all that. So we will get information from HMDA.

The call reports is another source.

Mr. HECK. What is that?

Mr. SILBERMAN. The call reports banks and credit unions all file is a second source of some data. And as you may know, we have been working with the FHFA to create a national mortgage database which would enable us, for the first time, to have a representative sample of all mortgages de-identified. And that will, when it is up and running, provide probably the best source of data, but we can't wait for that to be able to make calls.

Mr. HECK. I have another quick question, which I probably don't have time for.

We have tried very hard to provide carve-outs or exemptions to smaller institutions, in recognition that some of these things might not, again, best suit the purpose of the smaller institutions. What we are hearing, however, is that there is evolving a pressure toward best practices which comes from, "above the larger standards, rules, and regulations."

It is hard for me to ferret out exactly the origin of this. This is not for you, Mr. Silberman, I apologize; this is for Ms. Eberley and Mr. Fazio. Is this pressure, in your opinion, coming from examiners, from the consultants?

I would like a brief—because I have limited time—sense of, do you think that there is this kind of amorphous pressure, that even though we grant carve-outs, for which we think are very valid reasons, nonetheless kind of the cultural milieu and context mitigates against the very thing we are trying to accomplish in that regard?

Ms. Eberley, Mr. Fazio—I'm sorry. Pardon me?

Chairman NEUGEBAUER. Please respond in writing to the gentleman because we have some folks who need to catch airplanes.

Mr. HECK. I apologize, Mr. Chairman.

Chairman NEUGEBAUER. But it is a good question. And the witnesses will please respond to it.

I now recognize the gentleman from Texas, Mr. Williams.

Mr. WILLIAMS. Thank you, Mr. Chairman. And I want to direct my questions to Commissioner Cooper and Mr. Silberman.

My first question is to Commissioner Cooper. In your testimony, you spoke about the need for legislation to support NMLS' ability to process background checks. Regulatory efficiency is important for regulators and regulated entities. I personally understand this, being a small business owner.

Access to credible information is everything. So my question, Commissioner, is how will legislation you are working on with Congress promote this type of efficiency?

Mr. COOPER. Thank you, Congressman. First, let me say that since 2010, the NMLS that we discussed earlier has been processing background checks, and they have been doing it very efficiently on the mortgage loan side. What we want to make sure of is that the SAFE Act allows us to be able to use this same efficiency and use that on our other non-bank industries that we regulate, such as in Texas, where we regulate money services businesses. It takes approximately 2 weeks to get background checks. The NMLS system can do it in 24 hours. So we like that efficiency.

Mr. WILLIAMS. Okay. Thank you. And one other quick question. What is your definition of a community bank?

Mr. COOPER. Congressman, if I could, everybody here has been talking about what the pieces are for a community bank. And I

agree with most of it. What I think we have here—for instance, the FDIC definition that they use for data brings in about 6,000 banks. Chairman Hoenig's definition that was mentioned earlier brings in about the same amount less about 148.

My point is that we are so close in being able to come up with a definition that I would suggest that we would be able to get together and come up with these things. And we do have to have a—what I call a determinator—somebody who can decide on the differences. And that, in my recommendation, would be the chartering agency.

Mr. WILLIAMS. Thank you.

Mr. Silberman, in full disclosure I need to tell you that I am two things in this world. I am a car dealer, and I am a community bank shareholder. Now, the CFPB issued its guidance on indirect lending on March 31, 2013. And I think we need to be honest. This guidance was meant to intimidate indirect lenders and eliminate payments to car dealers whose customers have auto loans with higher interest rates. Would you agree with that? Yes or no?

Simple answer.

Mr. SILBERMAN. No.

Mr. WILLIAMS. Okay. Now, I know that the CFPB thinks that these payments lead to discrimination. And I can understand that back in March of 2013, your lawyers were too busy to go through the rulemaking process, so they took a shortcut. But now, more than 2 years have gone by since you issued the guidance. And as far as I can tell, you haven't made any effort to do what the law requires.

Now, if you want to create a rule that businesses have to follow—so my real question is this, first of all, what is the problem? And why aren't you even trying to do this the right way?

Mr. SILBERMAN. Congressman, thank you for the question. The problem that we have been addressing is that indirect auto lenders are engaged in practices that are producing disparities—

Mr. WILLIAMS. No, you don't know that.

Mr. SILBERMAN. We have found that through our supervisory work, through our investigative work.

Mr. WILLIAMS. All right. Next question, are you afraid that your statistics won't look so good by hiding this information?

Mr. SILBERMAN. I am not sure what information you are saying that we were hiding, Congressman—

Mr. WILLIAMS. You are not rulemaking. You are intimidating.

Mr. SILBERMAN. I respectfully disagree. We are not intimidating. We are not rulemaking because we have not made any rules. We have simply—what the bulletin simply announces is what has been well-established law for a long time in terms of the obligations of an indirect auto lender under the Equal Credit Opportunity Act.

We thought it was useful and important for us to put the banks that we examine on notice of our understanding of the law. And it is well-settled law. So there was not a rule to issue because there was no change in law.

Mr. WILLIAMS. Do you worry that the cost of compliance on business—small businesses and regulations could cost small businesses profits, and even put them out of business? Do you worry about that?

Mr. SILBERMAN. We are required by statute to think about that. And we think about the access, the intent—

Mr. WILLIAMS. Are you worried about that? Do you think it might put a long-time business out of business, because of the cost of meeting these regulations?

Mr. SILBERMAN. We are always concerned about access to credit for small businesses, as well as for consumers.

Mr. WILLIAMS. And what do you say when somebody says they are having to hire more compliance officers and loan officers in these banks?

Mr. SILBERMAN. Congressman, I think what we say is that we want to understand that. We want to make these rules as easy as possible to implement. That we have engaged in an extensive effort to try and assist and make it so that they don't need a lot of—don't have to lawyer up to implement the rules, and to adjust the rules so that we don't have a one-size-fits-all approach.

Mr. WILLIAMS. I appreciate your testimony.

Chairman NEUGEBAUER. The time of the gentleman has expired. I thank the gentleman.

And now the gentleman from Georgia, Mr. Westmoreland, is recognized for 5 minutes.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

Yesterday, Congresswoman Maloney and I reintroduced the Financial Institutions Examination Fairness and Reform Act. I am very excited to be working with Mrs. Maloney as she and I have worked together. And she has worked tirelessly to help the community banks.

To me, this bill addresses the major concerns my community banks have had with the regulators during the financial crisis. The core purpose of this bill is to provide financial institutions a way to appeal examination determinations to a neutral and independent third party. This independent examination review director is tasked with determining whether examiners have fairly and accurately applied rules and guidance from the regulators.

All too often, I have heard that banks in my community have nowhere to turn when an examiner makes a mistake or is applying rules unjustly. I would like for each of the Federal supervisors to just give a simple yes-or-no answer: Will you support or remain neutral on this bill?

Just a simple yes or no.

Ms. EBERLEY. No, sir.

Ms. HUNTER. Our agency doesn't have a position on it, so I am not in a position to say I would support it or not.

Mr. BLAND. Representative Westmoreland, we don't support it, no.

Mr. FAZIO. We have concerns with various aspects of the examination fairness bill.

Mr. WESTMORELAND. Mr. Silberman, do you have anything to say? Do you know anything about it?

Mr. SILBERMAN. No, sir.

Mr. WESTMORELAND. All right, good.

Ms. Eberley, you brought up a point about my colleague from Georgia, Mr. Scott and I, who have been working tirelessly on the failure of our community banks. You mentioned the acquisition de-

velopment and construction loans. It brings up why I think this bill that we have is so important, because it talks about nonaccrual, in placing loans in nonaccrual.

I was in the building business. I was in the development business. I was in the real estate business. I know for a fact that some of these loans that were current—they had been going by and abiding by all the terms of the loan. But they were forced to be put into nonaccrual, which took the cash position of these banks down.

Now, what is wrong with a small community bank being able to say, "Look, I know this guy. He has paid his loans. Why does it have to go into the nonaccrual status?"

Ms. EBERLEY. After the crisis of the late 1980s and early 1990s, Congress passed a law indicating that the financial institution regulators had to require institutions to follow generally accepted accounting principles (GAAP). So we don't have that flexibility. And then—

Mr. WESTMORELAND. And that is why we are trying to change the law.

Ms. EBERLEY. Right. And—

Mr. WESTMORELAND. But you don't want us to change the law?

Ms. EBERLEY. We have a couple of problems with the idea of an ombudsman that would overturn agency findings without having accountability for the supervision of institutions—

Mr. WESTMORELAND. So basically, the government agencies think you know more about a bank's borrowers than they do? Is that correct?

Ms. EBERLEY. No, sir. We require institutions to follow GAAP.

Mr. WESTMORELAND. Okay.

Ms. EBERLEY. And if they weren't following GAAP, they would essentially have two sets of books.

Mr. WESTMORELAND. Okay.

Ms. EBERLEY. They would have one set of books where they reflected it that way—

Mr. WESTMORELAND. Thank you.

Ms. EBERLEY. —and one for the regulators.

Mr. WESTMORELAND. And I am sorry you all opposed the bill.

I also wanted to talk about the Economic Growth and Regulatory Paperwork Reduction Act. In the past 15 years, there have been 801 regulatory rules that have gone in to these banks. My concern is that the volume and the complexity of these banking regulations is going to put more of our community banks out of business. And since Dodd-Frank, my understanding is that those rules will not be included in this next review. And so it will be, I think 2026, before these Dodd-Frank rules will be considered under this rule.

Can you tell me why Dodd-Frank rules aren't being considered in this next review? And can anybody tell me—after 801 regulations, can you tell me how many have been—because this was only up to 2006. How many have been after 2006? And what paperwork has been reduced, or what rules have been removed?

Mr. BLAND. Representative Westmoreland, I will take the first part.

Mr. WESTMORELAND. Sure.

Mr. BLAND. The bank regulatory agencies issued a letter that indicates that we will include all regulations that have been imple-

mented in the EGRPRA process, going forward, starting with our next hearing in Boston in May. All regulations also will be subject to the public comment period, including the Dodd-Frank rules that have been implemented.

Chairman NEUGEBAUER. The time of the gentleman has expired. But I would ask the other witnesses to respond to the gentleman's question in writing, as well.

I will now go to the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Ms. Eberley, in February you testified before the Senate Banking Committee. And I believe your testimony was to the effect that traditional banks were able to weather the financial crisis reasonably well, and are continuing to perform well. But as has been discussed here today, since 2010, when there were about 7,657 banks in the United States; 4 years later, by the end of 2014, that number had declined to 6,509 banks. At the same time, since the enactment of the Dodd-Frank Act, banks with less than $10 billion in assets have seen their market share decline by 12 percent, double the 6 percent decline of the 4 pre-Dodd-Frank years.

So again, to Ms. Eberley, referencing back to your February testimony in front of the Senate Banking Committee, when Senator Heller asked whether you thought industry consolidation was a concern, your response, I believe, was that most consolidation results from a financial crisis, so the way to prevent consolidation is to avoid crises through more regulation.

One of the goals of financial reform was to solve this problem of too-big-to-fail. And yet what we have seen is an avalanche of red tape coming in response to the financial crisis and a contraction of banks, a contraction of competition and choice, a consolidation of assets, and a concentration in fewer banks and bigger banks.

So my question to you is, do you still maintain that more regulation is needed? Or do you recognize that some of the avalanche of regulations is actually counterproductive from a standpoint of diminishing competition and exacerbating the problem of too-big-to-fail?

Ms. EBERLEY. I believe in that hearing I was referencing our study on consolidation, which showed that about 20 percent of the consolidation that had occurred over the last 30 years was attributed to two big crises, with failures from the crises. And what is in our control is to have good supervision, not regulation, but supervision to ensure that banks don't fail, so that we have good balanced supervision in good times and we don't go too far in bad times. I think that is very important.

Mr. BARR. Fair enough. And I am all for supervision and making sure that we don't have a financial collapse. But to kind of follow up on Mr. Guinta's line of questioning, where he was referencing only five new charters in the last number of years, I think Senator Shelby referenced only two de novo bank charters have been granted since the financial crisis.

My question really, following up your testimony in the Senate, is, do we really believe that it is a 6-year economic cycle that is to blame here? Or can we acknowledge that at least some of the rea-

son for the consolidation, some of the reason for the lack of new charters is overregulation?

Ms. EBERLEY. Certainly, the costs of operating in a regulated environment are factored in. But we have seen a tremendous amount of money come into community banks in the form of investment in that same timeframe, which suggests to me that community banks are still viewed as viable by the investing community, and that the cost of regulation isn't keeping them from coming in.

Mr. BARR. Let me just share a little anecdotal feedback from some of the small community banks in central and eastern Kentucky, which I represent. And I think they would be disappointed to hear that you all are opposed to basically fair exam procedures where you have an independent appeal process.

Basically, what a lot of these bankers are telling me is that they are no longer in the business of lending. They are in the business of paperwork and compliance. And for every $100,000 that they have to put into compliance, that is a million dollars less capital deployed in their communities. So I would hope that there would be some sensitivity to that.

Let me move on since I am running out of time, just really quickly to Commissioner Cooper. You mentioned in your written testimony that you support granting QM status to loans held in portfolio by a community bank. I have a bill called the Portfolio Lending and Mortgage Access Act.

Mr. Silberman, your agency opposes that legislation. Director Cordray is on record as opposing the legislation. My question to you, Commissioner Cooper, is can you explain your thinking and why you disagree with Director Cordray? Why is it that, as the top representative of State-based regulators, that you believe that portfolio lending encourages an alignment of interests between the lender and the borrower that would actually prevent some of the practices, the originate to distribute practices that led to the financial crisis?

Mr. COOPER. Congressman Barr, you said it very well. The community bank model does align the risk of the entity with the benefits of the consumer, and so we believe, CSBS believes and State regulators believe that community banks holding mortgages in portfolios should be exempt because it also has created a problem that we believe by survey that it is declining, and if we don't reverse this decline, we will continue to have obviously further decline.

Chairman NEUGEBAUER. I thank the gentleman.

Mr. BARR. Thank you.

Chairman NEUGEBAUER. The gentlewoman from Utah, Mrs. Love, is recognized for 5 minutes.

Mrs. LOVE. Thank you.

I want to get right into it. Just to be clear, Mr. Silberman, do any States lack the authority to implement ability to repay and roll over limits for State-licensed payday lenders?

Mr. SILBERMAN. Thank you Congresswoman.

Mrs. LOVE. I'm sorry, I can't see you.

Okay, there you are. Thank you.

Mr. SILBERMAN. Sorry.

So, we have been thinking about—our job is to ensure that consumers have the rights and protections that they are given by Federal law, and that is the question we have been asking rather than the question of what States can or cannot do.

Mrs. LOVE. We should be asking what States can or cannot do. Because if you think about it, Mr. Cooper asked, "Can you describe the authority that States have to regulate these products," and the answer was, "We have not thought about the States' ability to regulate. We feel like it is our job, something like our job to regulate these and try and figure out how we are going to protect consumers." Is that your assessment?

Mr. SILBERMAN. It is our assessment that it is our job to ensure that consumers have the rights that are provided to them under Federal law.

Mrs. LOVE. Have you identified any States that have failed to adequately protect its citizens?

Mr. SILBERMAN. As I say, our job is to—

Mrs. LOVE. Have you identified any States that have inadequately protected its citizens when it comes to these?

Mr. SILBERMAN. As I have indicated Congresswoman, that is not the question we were charged to ask, and that is not the question we have been asking.

Mrs. LOVE. Okay. So from what I can see here, if we already have States—by the way, two States have done away with these products. And you can't identify or are not willing to identify States that have failed to adequately protect citizens. It seems to me that the job is pretty much to protect your job if you are duplicating or stopping what States are trying to do.

Mr. SILBERMAN. Our job is to ensure that consumers are not subject to unfair, deceptive, or abusive acts or practices, that they get the disclosures that Federal law requires, that they get the protections that lending—

Mrs. LOVE. So your job is to stop States then, when it comes to these products? Because seriously, why do you think the national solution should be to trump the States? If the States are already regulating these products adequately, why do you feel like you need to replicate or trump what they are already doing?

I live in a State that does very well. As a matter of fact, these products are—we have not had any problems with these products. Our citizens love them. They think it is another option for them. And so now, here I am, in the House of Representatives, which is the branch of government that is closest to the people, by the way, and I am having to listen to you say, well, our job is to pretty much figure everything out for the States. What is the point in having States regulate these products?

Mr. SILBERMAN. So first, to be clear, I did not mean to say that—and if I said that, I apologize—our job is to trump the States. Our job—Federal law would not trump the States. It would establish a floor, which is, in a Federal system, the way things work. Just as the States, there is a Truth in Lending Act, and the States can add protections on top of that. There is a Truth in Savings Act, and the States can add additional protections. There is a Fair Credit Reporting Act. That is the job that Congress has given us and that we are intent on doing.

Mrs. LOVE. Okay.

It doesn't make any sense to me, if States are doing it, and you can't identify a State that is inadequately protecting its citizens, it seems to me if you are going to do what States are already doing, it is like I am just here to maintain my job. I need to do something, so I am going to do something that States are already doing. It makes absolutely no sense.

I just want to—I am going to shift over and just talk to Ms. Hunter about the Volcker Rule. As the Volcker Rule is being implemented, we are learning more and more about unintended consequences with the Rule.

One that has come up has to do with the non-financial companies that own depositories such as ILCS or unitary thrifts.

As the Volcker provision is drafted—if a non-financial company owns a depository, the Volcker requirement applies to all of their operation, even those that are not engaged in any financial services, which means that non-financial companys' ability to carry out some basic risk management could be seriously impacted or harmed. So, the question that I have is do you believe that the intent of the Volcker provision was applied to the non-financial affiliates in the industrial company that owns a depository?

Ms. HUNTER. I certainly understand the concern that you are raising, and the issue is really created in the Dodd Frank Act itself. You are correct when you say that it really applies the restrictions on proprietary trading and the investments and relationships with covered funds under the Volcker Rule. It applies to insured depositories and their affiliates.

Mrs. LOVE. But do you think that this is one of the unintended consequences, because we are impacting industries that are not in the financial services, and I just want—if it is okay on the record, I would love to have a comment on that in terms of a well-thought-out comment as if you believe that this was an unintended consequences.

Chairman NEUGEBAUER. Ms. Hunter, if you would send Mrs. Love a written response on that, we would appreciate it.

Ms. HUNTER. We would be happy to provide some information, yes.

Mrs. LOVE. Thank you.

Chairman NEUGEBAUER. Thank you.

And now the gentleman from California, Mr. Sherman, is recognized for 5 minutes.

Mr. SHERMAN. Thank you.

Mr. Silberman, my colleagues have heard me talk about the new TILA–RESPA forms. You are certainly aware that the real estate industry and the real estate closing industry is focused on this. One would expect some bumps in the road once these rules become effective. Have you have explored the idea of a reduction for a few months or a suspension of the penalties for the innocent errors that are likely to be made in the first few months of operation?

Mr. SILBERMAN. Thank you, Congressman.

The TILA–RESPA rules, the "Know Before You Owe" rules as we think about them, as you know, were issued in November of 2013. We did provide for a very long implementation period in order to ensure that they could be effectively implemented. We have been

working diligently with the industry to ensure that it could get implemented effectively.

I believe Director Cordray spoke to this issue when he was before the full committee last month and has some recent correspondence, and I think what he said is that we are focused right now on ensuring a successful achievement of the effective date, but that we always listen and will continue to listen to people's ideas about and around that.

Mr. SHERMAN. I hope you will listen to the idea that yes, you have an effective date, but it ought to be a soft date when it comes to either imposing governmental penalties or opening the door to civil lawsuits, because until you take it on a shakedown cruise, you don't know which part needs to be fixed.

Mr. Fazio had this great question about the need for supplemental capital that somebody else already asked a similar question. So instead, I will talk to you about how NCUA has not shown any instance where the lack of enforcement authority over credit union service organizations has been a material issue.

Is it correct that NCUA already has authority via the credit unions they regulate to review and dictate enforcement with regard to credit union service organizations, which insiders call CUSO—I was told to mention that to show that I really knew the industry.

It is my understanding that non-CUSO vendors are already subject to reporting and are reviewed through the Federal Financial Institutions Examination Council (FFIEC).

So, with the tight budgets that everyone in government faces, do you really need to get involved in this in a new way?

Mr. FAZIO. Thank you for that question, Congressman.

There are two aspects of that, and I will take the latter first. The non-CUSO vendors, third-party vendors that are not a credit union service organization, if they do business with banks, then they would be subject to oversight by the other FFIEC agencies. However, we have several vendors that are large that only serve credit unions as clients, and they are not CUSOs.

And so, they are not subject to regulatory oversight. There is a blind spot there.

And we have had—in fact, we have had problems with a few of those historically. In terms of CUSOs, in particular, to the former part of your question, we have had, in fact, some problems with CUSOs.

We have an indirect authority over CUSOs. We have a regulation that requires credit unions that do business with CUSOs or that own a CUSO to require certain things contractually, like access to books and records that they follow generally accepted accounting principles in preparing their financial statements and so forth.

However, it is a very indirect authority in that sense. We don't have insight into the full landscape of the credit union service organizations, and are limited to their books—and we have limits in how we can access and examine them in terms of understanding their business models.

We have seen problems historically in CUSOs, and I would say that CUSOs are a great opportunity for especially smaller credit unions to collaborate. We support that. The use of CUSOs achieves

economies of scale and allows small credit unions to do things they might not be able to do otherwise, independently.

But it also creates a gap in our ability to understand the nature of the risks to those credit unions.

In some cases, it doesn't—

Mr. SHERMAN. I would ask you at least not to duplicate the efforts of the Federal Financial Institutions Examination Council and—

Mr. FAZIO. And we would have no intention of doing so.

Mr. SHERMAN. Okay.

Mr. FAZIO. We cooperate and collaborate with them closely.

Mr. SHERMAN. I have 14 seconds left, so I will just point out that the gentleman from Florida, Mr. Posey, and I have a great bill that perhaps if the FDIC would focus on it, you could solve it at your level. You have bank holding companies where you would not have an invasion of the assets of the insurance company that they might hold. Should there be a liquidation, you need to do the same for thrift holding companies, because we have a State system of regulating insurance companies, and the assets of the insurance company need to be there to protect the policyholder, and shouldn't be raided by the FDIC for other purposes.

I will yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Pennsylvania, Mr. Rothfus, is recognized for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

I thank the panel for spending some time with us today and I appreciate your patience through the vote break.

Mr. Bland, I wanted to address a question to you.

As you know, mutually chartered financial institutions have a long history in the United States of serving their local communities and promoting Main Street economic growth.

Their structure grants them flexibility to take a long-term outlook rather than focusing on quarterly earnings, but it comes with a unique challenge as well. For example, mutual banks are constrained in their ability to pursue activities that best suit the needs of their communities by restrictions set out in the Home Owners Loan Act. The only option is to go through the time and expense of converting to a national bank charter, which is a particularly burdensome process for smaller and mutual institutions, as they must first convert to stock form before they can convert their charter.

To address this issue, Representative Himes from Connecticut and I have introduced bipartisan legislation, H.R. 1660, the Federal Savings Association Charter Flexibility Act, which provides all Federal savings associations, including mutual banks, with the option of offering a broader range of services similar to a national bank without the burdens associated with changing charters. This legislation establishes a simple election process for an institution to become a newly created covered savings association, and it includes important safeguards to prevent fire sales of assets and subsidiaries during the transition process while also preserving the ability of the OCC to enforce the law and prevent evasion.

I know this issue is near and dear to the Comptroller, so I would like to ask you, is the OCC supportive of the reforms in H.R. 1660?

Mr. BLAND. Representative Rothfus, as I said in my oral remarks and our testimony, we are very appreciative of you and others for supporting this bill. And as you indicate, the Comptroller is very sensitive and supportive of giving flexibility to the thrift industry. The Federal savings—

Mr. ROTHFUS. Would you agree that these institutions need and deserve more flexibility?

Mr. BLAND. Yes, they do. As originally structured, they were primarily limited to the mortgage space in terms of providing those services, but there are a lot of other entities that are involved in that, but they are still constrained by laws that limit the types of loans that they can do. And in fact, they have a lot of experience. And they can—consumer and commercial loans. But they do have a limit in which they can do that, so we are very supportive of providing the ability for them to continue their governance as a thrift, but to exercise the flexibility that other institutions have in terms of what is the right business model.

Mr. ROTHFUS. Thank you.

Ms. Eberley, I wanted to read something that I have received from one of my local community banks: "Two years ago, we—the bank—decided to appeal a matter for which an appeal process was applicable. When the on-site examiner communicated to the regional office that the bank was taking this action, a regional officer of the regulator responsible arranged a phone call with the bank and its legal counsel.

"The regional officer conceded during this call that the bank had the right to appeal the matter, but strongly suggested that the bank not do so.

"He informed us that he had already spoken to the so-called independent reviewers, and that we would lose that appeal."

I don't know about you, but I find this story pretty troubling in terms of the effectiveness and independence of the processes that currently exist for institutions to appeal material supervisory determinations. I think it also raises some due process issues. Worse still, it is not an isolated incident. And it is illustrative of many complaints that the committee has heard. So, I would like to get your response. In light of this example, wouldn't you agree that reforms to the examination process are warranted?

Ms. EBERLEY. The situation you describe would not at all be consistent with our process. And I would very much appreciate having the information to be able to reach out to the institution.

Our process is is that we do encourage institutions to try to resolve concerns at the lowest level possible, starting with—

Mr. ROTHFUS. But if this happened, wouldn't you agree that reforms—

Ms. EBERLEY. It would be inconsistent with our policies. We do have an independent review process that starts with the regional office. It next comes to me. I am a 28-year examiner. A group that is independent of the oversight of the region reviews all of the materials from the institution and from the FDIC, our reports of examination. They make a recommendation to me, but I make my own decision.

And if an institution doesn't agree with the decision that I make, they may appeal to our supervisory appeals review committee, which is an independent organization, headed by an independent political appointee.

Mr. ROTHFUS. Yes, we would like to follow up with you on that.

Ms. EBERLEY. I would be happy to.

Mr. ROTHFUS. I have also been increasingly concerned about consolidation in the community banking and credit union industry. As you may know, our recent study by researchers at Harvard's Kennedy School of Government found that this sort of consolidation is in fact occurring, and that the Dodd-Frank Act has accelerated the trend considerably.

In a hearing before the Senate Banking Committee on February 12th, you argued that the lack of a new bank increase is due to the economic cycle, versus one of the legislative barriers, or even regulatory barriers.

In light of the Harvard study, do you still stand by those remarks?

Ms. EBERLEY. I would have to point out a couple of things about the Harvard study. Number one, the market share definition was based on total assets, and we have spent a lot of time talking today about the importance of community banks lending in their communities.

If you actually look at market share of loans, community banks' market share declined in the 20 years leading up to the crisis, but since the crisis, it has stayed stable and actually it has increased about a tenth of a percent. So, a 20-year decline has stopped after the crisis.

Mr. ROTHFUS. I yield back. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Wisconsin, the chairman of our Oversight and Investigations Subcommittee, Mr. Duffy, is recognized for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

Ms. Eberley, you are part of the senior management of the FDIC, is that correct?

Ms. EBERLEY. Yes.

Mr. DUFFY. And do you report directly to Chairman Gruenberg?

Ms. EBERLEY. Yes, I do.

Mr. DUFFY. When Chairman Gruenberg gives you a directive, do you follow it?

Ms. EBERLEY. Yes, I do.

Mr. DUFFY. In your experience, you have been at the FDIC for some time, and part of the senior management team. When Chairman Gruenberg gives a directive, does senior management follow that directive?

Ms. EBERLEY. Yes.

Mr. DUFFY. Okay.

And so I want to talk to you about the FIL, the Financial Institution Letter that came out in January of this year. Did you participate in the writing of that?

Ms. EBERLEY. Yes, I did.

Mr. DUFFY. The part I think is important is that you have encouraged institutions to "take a risk-based approach in assessing

individual customers' relationships rather than declining to provide banking services to an entire category of customers." That is very important.

Were banks stopping business with a whole line of customers, in your experience, in the risk-based work you have done?

Ms. EBERLEY. We have heard a fair amount of anecdotal evidence of that. In fact, a group of pawnbrokers represented by the National Pawnbrokers Association came in and met with us and gave us a spreadsheet of customers who had lost their accounts.

Mr. DUFFY. Do you think that the decisions that were made by banks had anything to do with the regulation that came from the FDIC?

Ms. EBERLEY. In that particular case they gave us a list of 49 institutions, only one of which was supervised by the FDIC, and that institution's decision appeared to be a risk-based decision based on the reasons that they had provided to the customer.

Mr. DUFFY. So based on your work, have you seen any evidence that the FDIC has a list of prohibited businesses that they send out to banks?

Ms. EBERLEY. The FDIC does not have a list of prohibited businesses.

Mr. DUFFY. Are their regional directors part of the senior management team?

Ms. EBERLEY. Yes, they are.

Mr. DUFFY. And they are the ones who also follow the directive of Chairman Gruenberg?

Ms. EBERLEY. They report to me.

Mr. DUFFY. They report to you?

Ms. EBERLEY. Yes.

Mr. DUFFY. So if there is a consent decree, or a memo of understanding that is sent out, do you see those?

Ms. EBERLEY. It would depend on the level. Much of our enforcement action is delegated.

Mr. DUFFY. Okay, do you see those? Not all of them?

Ms. EBERLEY. I see some.

Mr. DUFFY. But not all?

Ms. EBERLEY. No, not all.

Mr. DUFFY. Would you be surprised to learn that there are memos of understanding or consent decrees that go out with prohibited products?

Ms. EBERLEY. I would be very surprised, and I would want to see them.

Mr. DUFFY. There was an investigation that was done by the Oversight Subcommittee. We received documents from the FDIC. They did a report. I know Chairman Gruenberg has seen it. I am sure you probably have seen that report. And the documents are referenced, and I have them in my hand.

I have one while you were the Director of Risk Management, these folks report to you, Anthony Lowe from Chicago, prohibited acts. And by the way, the definition of "prohibit" according to dictionary.com is to forbid. Payday lenders. Would that surprise you?

Ms. EBERLEY. You mentioned consent orders and memoranda of understanding. And I am familiar with the information that we provided to the committee.

Mr. DUFFY. Are you surprised by this?

Ms. EBERLEY. And none of those had any language that said that there are no MOUs or consent orders turned over to the committee that would have any language that says that. There shouldn't be any that would say that.

Mr. DUFFY. I have one from 2013.

Ms. EBERLEY. I would want to see the document that you have.

Mr. DUFFY. Prohibited businesses.

Ms. EBERLEY. Can I see the document?

Mr. DUFFY. Firearm sales.

Can we take a recess, Mr. Chairman? I will show her the documents.

Well, I can circle back.

So are you saying that—

Ms. EBERLEY. I would like to see the document.

Mr. DUFFY. Okay, but you would be surprised by this?

Ms. EBERLEY. I would be very surprised.

Mr. DUFFY. Would this be outside their lane and the directive that was given by you and Chairman Gruenberg?

Ms. EBERLEY. To include prohibited businesses in a consent order or an MOU?

Mr. DUFFY. Yes.

Ms. EBERLEY. It would be prohibited.

Now, there are consent orders where we have told institutions they need to exit a line of business because they weren't managing it properly.

Mr. DUFFY. But the list that I see looked pretty similar to the high-risk list that was issued in 2011.

Ms. EBERLEY. No, that would not be consistent with policy.

Mr. DUFFY. Okay.

Ms. EBERLEY. So I would need to see what you have.

Mr. DUFFY. So if these are being issued, we have rogue individuals operating inside the FDIC, right? Because obviously you wouldn't give the directive, and your testimony is that Chairman Gruenberg wouldn't give the directive. These are rogue folks, right?

Ms. EBERLEY. There are no consent orders or MOUs that contain that kind of information, to my knowledge.

Mr. DUFFY. And you are certain of this?

Ms. EBERLEY. I said to my knowledge, there are none. I would like to see the document that you are holding.

Mr. DUFFY. And have you reviewed a lot of—obviously, there is an investigation going on.

Ms. EBERLEY. Yes, sir.

Mr. DUFFY. And you haven't seen any?

Ms. EBERLEY. I have not, sir. I would like to see the document that you are reviewing.

Mr. DUFFY. Okay.

I will provide them after, but these were documents that were given to our committee from the FDIC that were referenced in the report.

I guess my time has expired. I yield back.

Chairman NEUGEBAUER. Without objection, we are going to have a quick second round, and I am going to recognize the gentleman from Georgia, Mr. Westmoreland, for a quick 5 minutes.

Mr. WESTMORELAND. A quick 5 minutes.

First of all, I want to thank all of the witnesses for your patience in sticking around.

Ms. Eberley, when you did your report on what was the main cause of all the bank failures that we had, did you find that the non-accrual was one of the main reasons for some of these bank failures, or was there another thing that led to the bank failures?

Ms. EBERLEY. Our Inspector General has conducted a material loss review on most of the failures and they are required by statute, as you know, for ones that exceed a certain threshold. And they have done a couple of overview reports, and the commonalities between the institutions that failed were that they had heavy concentrations of credit. They grew rapidly and they funded that growth with broker deposits. So those are the three characteristics of the institutions that failed.

Mr. WESTMORELAND. But being the Director of Risk Management at the FDIC, did you do your own study of what may have caused these?

Ms. EBERLEY. I have certainly participated in the material loss review discussions with our Inspector General.

Mr. WESTMORELAND. But you didn't find—the non-accrual regulation had anything to do with these failures?

Ms. EBERLEY. No, sir, non-accrual is an accounting determination of whether or not you are recognizing income on a cash basis, or I'm sorry, on your accrual basis on your balance sheet. If you are still getting paid on a cash basis, there is money coming in.

And so, that wouldn't cause a failure.

But if it is not accrual because a customer is not paying and you are not getting the repayment on the loan, that will contribute to a failure, will contribute to problem loans.

Mr. WESTMORELAND. Okay.

So, you don't think the non-accrual aspect of a bank that had to put current loans in that category had anything to do with it?

Ms. EBERLEY. I believe our Inspector General studied that and has provided the answer that was requested.

But I—

Mr. WESTMORELAND. Could you just share it with me right now?

Ms. EBERLEY. I do not, and that was their conclusion as well.

Mr. WESTMORELAND. Okay.

Now, you mentioned, and Mr. Bland and Mr Fazio, that you were opposed to the bill that Mrs. Maloney and I have dropped. How do you make that opposition known?

Ms. EBERLEY. I am not sure of the question.

You asked a question and you had described—

Mr. WESTMORELAND. Did you support or not support it?

Ms. EBERLEY. Right, and you described the—

Mr. WESTMORELAND. And you said no.

Ms. EBERLEY. —two provisions, so the ombudsman to overturn—

Mr. WESTMORELAND. Right.

Ms. EBERLEY. —regulatory findings and also the not having to put loans on non-accrual.

Mr. WESTMORELAND. So you don't think—

Ms. EBERLEY. So those are two things that give us great concern as a regulator.

Mr. WESTMORELAND. I know. But how would you go about making your opposition to it known?

Would you go into Members' offices? Would you send a letter out?

How do you make your opposition known, or do you just oppose and don't say anything?

Ms. EBERLEY. No, sir, we answer your questions when you ask.

And we will share our concerns. We are happy to try to work with you.

Mr. WESTMORELAND. No, I know. But do you share that with with Members of Congress?

Do you call them, or go into their office?

Ms. EBERLEY. I do not personally, no.

Mr. WESTMORELAND. Does anybody who works for you do that?

Ms. EBERLEY. No.

Mr. BLAND. Representative Westmoreland, we have had a lot of discussions with Members of Congress and their staffs around this legislation with respect to the timeframes for exams, the ombudsman and our concerns about the non-accrual language. And so we would engage Members of Congress in this discussion—

Mr. WESTMORELAND. So would you consider that a lobbying effort?

Mr. BLAND. No, we consider it being responsive to the question, like you asked today of whether or not we support it, and we express our concerns about what we think might be the unintended consequences of the law.

So we engage in that discussion.

Mr. WESTMORELAND. I appreciate you looking at unintended consequences, because the Administration has certainly caused a bunch of them.

Mr. Fazio, how about you, how do you get your concerns out?

Mr. FAZIO. Similar to what Mr. Bland indicated, we have conversations with committee staff or your staff members. And in fact, oftentimes the staff reaches out to us for our input to try to identify unintended consequences or issues that the bill would create.

Mr. WESTMORELAND. Okay.

I am assuming that you don't agree with everything that comes out of Congress, and we certainly don't agree with all of your regulations, so I think it will be a fair fight.

But again, thank you all for your patience, and I yield back.

Chairman NEUGEBAUER. I thank the gentleman, and I know the panel will be glad to hear that will be the last questioner.

The gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Thanks for the excellent hearing.

And thanks to all the panelists and thanks for your patience as—this is going to be the last round of questioning.

I do want to just follow up a little bit, Ms. Eberley, with the comments and the feedback I am getting from these community banks supervised by the FDIC. And one of the common themes in addition to the compliance costs and the intrusiveness of some of the exams in terms of taking personnel off of the actual business of banking, which is lending, is the idea among particularly small,

non-systemically important institutions in rural Kentucky that there is a trickle-down effect.

There is a trickle-down effect with these regulations, where regulations that were maybe originally intended for large, systemically important financial institutions are being applied to smaller banks, often in the form of the examination process, where examiners are coming into the small bank, identifying those regulations as best practices, even regulations that specifically don't apply to the smaller institution, and yet because these are "best practices," these small institutions with small compliance staffs are nonetheless being asked to comply with the larger standards.

Can you comment on that?

Ms. EBERLEY. Certainly. That would not be consistent with our policy.

Mr. BARR. I know that has been your testimony all day today. It is not consistent with your policy. I heard that with respect to Congressman Rothfus' example as well. It is not consistent. And yet, we are hearing from our regulated constituent banks that it is in fact happening.

Ms. EBERLEY. I would ask you to ask them to contact me.

Mr. BARR. Okay. And I have heard that response as well.

Just forgive me for my frustration, and I am sorry I appear frustrated, but here is the problem. What they tell me is they don't want to be identified. They don't want to be identified because they feel it is intimidating.

And so when I say I am disappointed that you all don't want maybe even a version of the Westmoreland bill, which is a fair exam reform bill that would provide for independent review of your exams, the reason why that is necessary is because our institutions don't want to be identified because they fear retaliation, because there is not an independent review of your exams.

So, do you have any sympathy for that concern, that if we do identify our banks to you, these banks who have concerns, that you will take a retaliatory approach?

And there is no legitimate objective appeal. It is just a rubber stamp affirmation of the previous review by your examiner.

Ms. EBERLEY. Examination findings have been overturned where they are incorrect. We absolutely do that in the appeals process.

Mr. BARR. How often is that?

Ms. EBERLEY. It is not frequent. There are not a lot of appeals that come forward in the formal process. Issues are generally resolved at the lowest level.

Mr. BARR. Let me—

Ms. EBERLEY. But we really—

Mr. BARR. Okay.

Ms. EBERLEY. —guard against the idea of the trickle-down with statements of applicability on all of our financial institution letters as to whether they are applicable to banks under a billion dollars. There is a review process for every report of examination to make sure it is consistent with our policy, so if that is happening, it is very troubling to me, and I really would want to talk to the institutions. It would be very helpful.

Mr. BARR. We will continue to work on that.

And I want to give the regulators—the OCC, the Fed, and FDIC—some credit because I heard in your testimony that you were interested in a longer examination cycle for highly-rated community banks.

I have that provision in legislation I have introduced called the American Jobs and Community Revitalization Act. The proposal that I have would take it up to a billion dollars, so banks under a billion dollars in assets that are highly rated could move to that 18-month exam cycle.

So, I appreciate the recognition that might be appropriate in the good area of agreement between those of us who want to see regulatory relief and the regulators, and I would encourage you to continue to take that position.

Just really quickly, with the time remaining, let me turn to Mr. Silberman in indirect auto lending guidance. Was the Bureau's objective to change the behavior of many of these auto lenders?

Mr. SILBERMAN. No sir, the Bureau's objective was to allow the indirect auto lenders—I'm sorry, could you repeat the question?

Mr. BARR. Yes, the question is, was the Bureau's objective in the guidance in the bulletin to change the behavior of auto lenders?

Mr. SILBERMAN. If we are talking about indirect auto lenders, the Bureau's objectives—

Mr. BARR. Not dealers, lenders within your jurisdiction.

Mr. SILBERMAN. Yes. Indirect auto lenders. Right.

So yes, the Bureau's objective was to let the indirect auto lenders know our understanding of the law so that when we came in—

Mr. BARR. Why? Are you doing that so that you can change their behavior?

Mr. SILBERMAN. It depends on what their behavior is, sir.

Mr. BARR. Okay. So if this is just a restatement of existing law—

Mr. SILBERMAN. Yes.

Mr. BARR. —you are not trying to change behavior? If you are trying to change behavior, you are in violation of the Administrative Procedure Act (APA) because you are not doing this through notice-and-comment rulemaking. And I would submit that you have violated the APA on this, and I would encourage you to do a rulemaking on this.

With that, I have run out of time, but I appreciate the chairman's indulgence.

Chairman NEUGEBAUER. And I am going to now renege a little bit. I am going to allow the gentleman from Wisconsin, Mr. Duffy, 2 minutes for the final question.

Mr. DUFFY. Ms. Eberley, you have indicated that you have reviewed the OGR report. I appreciate that. And I think you have seen a number of emails in there that are pretty damning to the FDIC, and they are targeting payday lending. One of them, from Thomas Dujenski, the regional director from Atlanta, as you have indicated, part of the senior team and who answers to you and to Chairman Gruenberg. In one of those emails, he says, "I am pleased we are getting the banks out of payday bad practices. Another bank is griping, but we are going to be doing good things."

There are a number of emails in here that are very clear that top management at the FDIC is targeting payday lending, and some banks and ammunition manufacturers. You have seen that

report. And then to come in here, when I have now provided you the documents that have come from the FDIC, and say, "I had no idea that the FDIC was at a high level targeting payday lending; I am surprised by that." And I guess, I would like—if you have seen these emails, and you now have the documents in front of you, do you still say this is not a senior management issue where we are targeting certain lines of industry through the FDIC?

Ms. EBERLEY. The question that you had asked me previously was whether the FDIC included lists of prohibited customers—

Mr. DUFFY. I am asking you this question.

Ms. EBERLEY. —in consent orders and MOUs. Neither of the documents that you have given me are FDIC documents. They are documents sent from financial institutions to the FDIC.

Mr. DUFFY. My question is—they are from regional directors.

Ms. EBERLEY. No, they are to regional directors. They are letters from financial institutions.

Mr. DUFFY. So in regard to the emails and the exchanges that have been made by Mr. Dujenski from Atlanta in regard to payday lending, have you seen those?

Ms. EBERLEY. Yes, I have.

Mr. DUFFY. And are you surprised by that, or did you give him that directive?

Ms. EBERLEY. No, I was very surprised by that.

Mr. DUFFY. So what consequence happened to Mr. Dujenski? Was he fired?

Ms. EBERLEY. Mr. Dujenski—

Mr. DUFFY. He was fired right?

No? He retired with full benefits and full pay?

Ms. EBERLEY. Yes. Mr. Dujenski is retired.

Mr. DUFFY. Mr. Lowe in Chicago, anything—any action taken with him?

Ms. EBERLEY. If you are referring to the letter that Mr. Lowe issued, in response to that we issued a clarification to the industry to make sure that our policy was clear not just to the industry, but within our organization, and our Inspector General is investigating the—

Mr. DUFFY. So Mr. Lowe was unclear on that matter, then.

Ms. EBERLEY. —totality of the matter, and I didn't—they will make a presentation of that at a Board level, and a decision will be made.

Mr. DUFFY. I yield back.

Chairman NEUGEBAUER. The time of the gentleman has expired.

I would like to thank our witnesses for their testimony today.

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.

And with that, this hearing is adjourned.

[Whereupon, at 1:05 p.m., the hearing was adjourned.]

A P P E N D I X

April 23, 2015

For Release Upon Delivery

9:15 a.m. on April 23, 2015

TESTIMONY OF

TONEY BLAND

SENIOR DEPUTY COMPTROLLER

FOR MIDSIZE AND COMMUNITY BANK SUPERVISION

OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

HOUSE COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

April 23, 2015

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

I. Introduction

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, thank you for the opportunity to appear before you today. In response to the Subcommittee's invitation letter, my testimony focuses on the challenges facing small national banks and federal savings associations (hereafter referred to as community banks) and the work of the Office of the Comptroller of the Currency (OCC) to help these institutions remain a vibrant part of our nation's financial system. I also discuss specific steps we are taking to address regulatory burden on community banks, OCC recommendations for legislative action in furtherance of this goal, and our progress on the review required pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).

Before describing these initiatives, I would like to share the OCC's perspective on community banks. The OCC supervises approximately 1,400 institutions with assets under $1 billion. These community banks provide many of the essential financial services and much of the credit necessary for our nation's economic growth. Throughout the country, these banks help small businesses thrive by offering personalized service and credit products tailored to their customers' needs. In addition, these banks and their employees strengthen our cities and towns by helping to meet municipal finance needs and actively participating in civic life.

Overseeing the safety and soundness of community banks is central to the mission of the OCC. Approximately two-thirds of our examination staff is dedicated to the supervision of these institutions. In my role as Senior Deputy Comptroller for Midsize and Community Banks, I regularly meet with community bankers to hear first-hand about their successes, their challenges, and their frustrations. I have seen how well-managed

community banks weathered the financial crisis and provided a steady source of credit to their communities. But I have also heard their concerns about the long-term viability of their business models. In addition, I have heard about their frustration with the time and resources they spend trying to track and comply with regulatory requirements — time and resources they believe could be better spent responding to the needs of their customers and communities.

We take these concerns seriously and are taking steps to help community bankers meet these challenges and navigate the changing regulatory landscape by ensuring that the OCC's supervisory policies and regulations are appropriately tailored to community banks.

II. The OCC's Approach to Community Bank Supervision

The OCC is committed to fostering a regulatory climate that allows well-managed community banks to grow and thrive. We have built our supervision of community banks around local field offices where the local Assistant Deputy Comptroller (ADC) has responsibility for the supervision of a portfolio of community banks. Each ADC reports up to a District Deputy Comptroller who, in turn, reports to me. Our community bank examiners are located in over 60 communities throughout the United States, close to the banks they supervise.

Through this supervisory structure, community banks receive the benefits of highly trained bank examiners with local knowledge and experience, supplemented by the resources and specialized expertise that a nationwide organization can provide. Our bank supervision policies and procedures establish a common framework and set of expectations. Portfolio managers tailor the supervision of each community bank to its individual risk profile, business model, and management strategies. We give our ADCs considerable decision-making authority,

reflecting their experience, expertise, and first-hand knowledge of the institutions they supervise, and we expect them to make most supervisory decisions locally.

We also seek to ensure that we apply our supervisory policies, procedures, and expectations in a consistent and balanced manner. For example, a key element of the OCC's supervisory philosophy is open and frequent communication with the banks we supervise. In this regard, my management team and I encourage bankers with concerns about examination findings to raise these concerns with their examiners and with the district management team that oversees the bank. Our ADCs and District Deputy Comptrollers expect and encourage such inquiries.

If a banker does not want to pursue these avenues of communication, our Ombudsman provides a venue for bankers to discuss their concerns, either informally or formally. The OCC's Ombudsman is fully independent of the supervisory process, and he reports directly to the Comptroller. This office provides bankers with an impartial ear to hear complaints and a mechanism to facilitate the resolution of disputes with our examination staff, in addition to hearing formal appeals of supervisory determinations.

The OCC's multi-layered, informal and formal process for addressing concerns about examination findings encourages the resolution of disagreements at various stages of the examination cycle and with various management levels within the OCC. Furthermore, as a safeguard, the Ombudsman contacts a bank or savings association 60 days after resolution of an appeal and again 60 days after the first examination following an appeal resolution to make sure that no retaliatory action has been taken by an OCC examiner for an institution's use of the appeal process. This communication is confidential and independent, and we believe that the institutions we supervise are confident that they can respond candidly.

III. Tailored Supervision

The OCC understands that a one-size-fits-all approach to supervision is not always appropriate, especially for community banks. We recognize that community banks have different business models and more limited resources than larger banks. Therefore, where we have the flexibility under the law, we seek to tailor our supervision to a bank's size and complexity, and we factor these differences into the rules we write and the guidance we issue.

The OCC seeks to minimize burden on community banks through various means. Examples of ways in which we tailor our regulations to accommodate community banks, while remaining faithful to statutory requirements and legislative intent, include explaining and organizing our rulemakings so these institutions can better understand their scope and application, providing alternative ways to satisfy regulatory requirements, and using regulatory exemptions or transition periods.

For example, the OCC, Federal Deposit Insurance Corporation (FDIC), and Board of Governors of the Federal Reserve System (Board) jointly drafted the final risk-based regulatory capital rule to reflect the nature and complexity of the different institutions we regulate. Although some provisions in the rule apply broadly, many requirements, including the supplementary leverage ratio and the countercyclical capital buffer, apply only to the largest banking organizations, which engage in the most complex and high-risk activities. We also adjusted the final rule to address significant concerns raised by community bankers by retaining the capital treatment for residential mortgage exposures and allowing community banks to elect to continue the treatment of certain accumulated other comprehensive income (AOCI) components. This treatment of AOCI helps community banks avoid introducing substantial volatility into their regulatory capital calculations. And we continue to explore additional ways to

tailor the capital rules to respond to community bank concerns and proposals, consistent with our objective of ensuring appropriate levels and quality of capital.

The OCC also responded to community bank concerns when we finalized our revised lending limits rule, issued in accordance with section 610 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), to include counterparty credit exposure arising from derivatives and securities financing transactions. Specifically, the rule exempts from the lending limit calculations certain securities financing transactions most commonly used by community banks. It also permits small institutions to adopt compliance alternatives commensurate with their size and risk profile by providing flexible options for measuring covered counterparty credit exposures, including an easy-to-use lookup table.

Our final rule implementing the Volcker Rule provisions of the Dodd-Frank Act is another example of how we seek to adapt statutory requirements to activities at different sized institutions, where possible. The statute applies to all banking entities, regardless of size; however, not all banking entities engage in activities covered by the prohibitions in the statute. One of the OCC's priorities in the interagency Volcker rulemaking was to make sure that the final regulations imposed compliance obligations on banking entities in proportion to their involvement in covered activities and investments. The rule, however, does not exempt community banks from the requirement to assess their activities and determine whether they are covered by the rule. As noted later in my testimony, we have submitted a legislative proposal that would exempt small banks from this rule.

The OCC is constantly seeking to improve how we communicate information to community banks and to provide tools and resources to assist them in identifying and managing their risks. We have designed the bulletins announcing the issuance of each new regulation or

supervisory guidance so that these banks can quickly assess whether the issuance applies to them, and we include a "highlights" section that identifies the key components of the rule or guidance. We also provide plain language descriptions of complex requirements to assist community bankers in understanding newly issued rules. For example, we provided community banks with a quick reference guide to the mortgage rules issued by the Consumer Financial Protection Bureau. We also produced a streamlined, two-page summary of the final domestic capital rule, highlighting aspects of the rule and key transition dates applicable to community banks. We supplemented this summary with an online regulatory capital estimator tool for banks, which we developed with the other federal banking agencies. The agencies augmented the estimator tool with a supplemental tool that banks may use to help calculate regulatory capital requirements for securitization exposures.

In addition, the OCC has focused on providing community banks with tools to assist them in determining whether they are adequately prepared to address cyber threats. This has been a particular emphasis of both the Comptroller and the Federal Financial Institutions Examination Council (FFIEC). Last year, members of the FFIEC, including the OCC, piloted a cybersecurity assessment at more than 500 community institutions to evaluate their preparedness to mitigate cybersecurity risks. The assessment supplemented regularly scheduled exams and built upon key supervisory expectations contained within existing FFIEC information technology handbooks and other regulatory guidance. The agencies subsequently published *FFIEC Cybersecurity Assessment General Observations*,[1] which includes questions for bank management to consider when assessing their institutions' cybersecurity preparedness. We understand that community banks have found this information helpful in assessing their own

[1] http://www.ffiec.gov/press/PDF/FFIEC_Cybersecurity_Assessment_Observations.pdf.

strengths and weaknesses in this important area. Last month, the FFIEC provided an overview of its cybersecurity priorities for the remainder of 2015, which include the issuance of a self-assessment tool to assist institutions, including community banks, in evaluating their inherent risk and risk management capabilities with respect to cybersecurity.

Through our secure BankNet website, the OCC provides other tools targeted to community banks. These include a portfolio-level stress test tool designed to provide bankers with a simple method to perform portfolio stress testing on income producing commercial real estate loans. OCC examiners developed this optional tool in response to requests from community bankers seeking additional guidance on how to stress test their loan portfolios. Another popular tool allows bankers to develop customized peer reports that they can use to compare their bank's balance sheet and financial performance ratios to those of other banks.

The OCC's *Semiannual Risk Perspective* provides bankers with an analysis of current market and risk trends that may affect their institutions. Because we recognize that community banks may face different challenges than larger banks, the report discusses risks from both a large and small bank perspective. We supplement this semiannual report with periodic webinars, generally targeted to community banks, on emerging risk topics. For example, the FFIEC conducted a webinar for community banks on "Executive Leadership of Cybersecurity." More than 5,000 Chief Executive Officers of community institutions registered for this event. The goal of this and similar webinars is to provide community bankers with practical information to help them mitigate emerging risks and to understand and comply with supervisory expectations.

IV. Other Burden Reduction Opportunities

When considering proposals to reduce burden on community banks, the OCC seeks to ensure that the proposals do not compromise fundamental safety and soundness or consumer

protection safeguards. Within this framework, the OCC is committed to exploring additional ways to reduce unnecessary regulatory burden on community banks. To this end, we are undertaking several regulatory review projects designed to reduce burden, particularly on community banks, and are considering other innovative approaches to address this issue. Late last year, we drafted and submitted three legislative proposals to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs, which provide a statutory basis to revise our regulations and reduce burden on covered institutions, if enacted. These proposals, which I describe below, are the product of both our on-going dialogue with smaller institutions and our supervisory expertise with both large and small banks and savings associations. The OCC would be pleased to share these proposals, as well as our experience and expertise, with this Subcommittee as it considers legislative options to address regulatory burden.

A. Legislative Proposals

Amendments to the Scope of the Volcker Rule. The risks to the financial system of proprietary trading and owning or sponsoring private equity and hedge funds are far more significant when larger institutions engage in these activities than when community banks do so, to the extent they even engage in such activities. Yet, the Volcker Rule contains no exemption for community banks. Accordingly, community banks need to ascertain whether their activities are covered by the Volcker Rule in order to understand whether they have any compliance obligations. Making this determination may require them to expend money and resources — for example, by hiring attorneys and consultants. This regulatory burden is not justified by the risk these institutions present.

In response to concerns raised by community institutions and issues that have arisen during our ongoing Volcker Rule implementation efforts, the OCC drafted a legislative proposal to exempt from the Volcker Rule banks with total consolidated assets of $10 billion or less. This proposal would eliminate unnecessary burden for small banks while ensuring that we address the risks the Volcker Rule sought to eliminate. Where a community bank engages in activities covered by the current Volcker Rule, the OCC could address any concerns as part of its normal safety and soundness supervisory process. Based on our analysis, we estimate that this amendment could exempt more than 6,000 small banks, including small banks regulated by the OCC, from the requirement to comply with the regulations implementing the Volcker Rule.

Revisions to the Examination Schedule. The OCC generally examines national banks and federal savings associations with total assets greater than $500 million on a 12-month cycle. We believe, however, that there are additional healthy, well-managed community banks that should qualify for the 18-month examination cycle. Accordingly, the OCC drafted a legislative proposal to increase from $500 million to $750 million the asset-size threshold that determines whether a community bank can qualify for an examination every 18 months, rather than every 12 months. The OCC would continue to use off-site monitoring tools to identify potential problems in these low risk institutions and, if warranted, could examine the institution more frequently.

This proposal is consistent with the incremental approach that Congress has taken when increasing the threshold amount of assets that permits small institutions to qualify for the 18-month examination cycle. Furthermore, it would allow the OCC to more appropriately align our supervisory resources with risk, while simultaneously reducing the regulatory burden on small, well-capitalized, and well-managed institutions. We estimate that this amendment would affect more than 400 banks, including banks regulated by the OCC.

I am pleased to see that some Members of Congress, including Representatives Barr and Tipton, have taken an interest in this issue and introduced legislative proposals to expand the examination cycle for additional community banks.

Changes to Permissible Activities for Federal Savings Associations. Currently, the powers of federal savings associations are set out in the Home Owners' Loan Act (HOLA), which establishes lending and investment limits for these institutions. Federal savings associations have told us that they would like to engage in additional activities to serve their communities but are unable to do so because of the HOLA limits. Under existing law, their only option is to convert to a bank charter, a process that can impose costs and burden that we believe can be alleviated.

To address these concerns, the OCC offered legislation that would give a federal savings association a choice: continue to operate as a traditional thrift or file a notice to be treated as a "covered savings association." Generally, a covered savings association would have the powers of and be subject to the same restrictions as a national bank. In practice, this means that a federal savings association that becomes a covered savings association would gain national bank powers but would have to discontinue activities not permissible for a national bank, subject to rules governing non-conforming assets and subsidiaries. This option would provide a federal savings association with the flexibility to retain its current corporate form and governance structure without unnecessarily limiting the evolution of its business plan. If a federal savings association's business plan changed after it became a covered savings association, it generally would be permitted to reverse its election and regain its traditional thrift status after an appropriate period. This option would allow these institutions to adapt to changing economic and business environments and to better meet the needs of their communities. As the supervisor of

both national banks and federal savings associations, we are well-positioned to administer this type of framework given our familiarity with the individual institutions and their governing statutes.

I would like to take this opportunity to express my appreciation for the significant efforts of Representatives Rothfus and Himes, who recently introduced H.R. 1660, the Federal Savings Association Charter Flexibility Act of 2015. If enacted, this bill will bring the type of flexibility and regulatory relief I describe above to our nation's federal savings associations.

B. Current Initiatives

While the OCC calibrates individual regulations to account for differences in the size and complexity of institutions as they are developed, we recognize the need to periodically assess how existing rules can be modified to ease regulatory burden on banks. The OCC has several projects underway, and we are considering other approaches to achieve this goal.

Integration of National Bank and Savings Association Rules. The Dodd-Frank Act transferred to the OCC all functions of the Office of Thrift Supervision (OTS) relating to the examination, supervision, and regulation of federal savings associations. Following the transfer of OTS rulemaking functions to the OCC, we began a comprehensive, multi-phase review of our regulations and those of the former OTS to reduce burden and duplication, promote fairness in supervision, and create efficiencies for national banks and federal savings associations. Last spring, we issued a proposal to integrate our bank and saving association rules relating to corporate activities and transactions into a single set of rules, where possible. Many of the changes included in the proposal would reduce burden for all institutions, including community banks. We are working on a final rule to implement these changes and hope to issue it in the near future.

EGRPRA. The OCC, FDIC, Board, and FFIEC are currently engaged in a review of their regulations, as required by EGRPRA. Specifically, the statute requires that, at least once every ten years, the agencies seek public comment on rules that are outdated or otherwise unnecessary. This provides both the agencies and the public with an opportunity to recommend ways to reduce burden.

To carry out the EGRPRA review, the agencies plan to publish at least four *Federal Register* notices, each addressing one or more categories of rules. To date, we have published two notices, each seeking comment on three categories of rules. In each notice, we specifically ask the public to identify ways to reduce unnecessary burden associated with our regulations, with a particular focus on community banks. We plan to issue a third *Federal Register* notice soon, seeking comment on three additional categories, followed by one or more additional notices on the remaining rules.

In addition, the agencies recently decided to expand the scope of the EGRPRA review in order to be as inclusive as possible. Accordingly, the agencies will solicit comment on all of our regulations issued in final form up to the date that we publish our last EGRPRA notice for public comment. We will provide more information regarding this expanded EGRPRA review in the next EGRPRA *Federal Register* notice.

The agencies received over 40 comments on the first *Federal Register* notice, and the comment period on the second *Federal Register* notice is still open. We carefully review all comments we receive to identify areas where changes would be appropriate. In addition, we are undertaking our own review of these rules, and the statutes they implement to assess whether there are areas where we can reduce burden without compromising safety and soundness. This

project is very important to the Comptroller, and we are hopeful that it will yield positive results, particularly for community banks.

In addition, the agencies are holding a series of EGRPRA outreach meetings to give members of the public an opportunity to present their views in person. The outreach meetings feature panel presentations by industry participants and consumer and community groups. To date, we have held outreach meetings in Los Angeles and Dallas, and I have participated in each of these meetings to hear first-hand the views and recommendations offered by the many participants. We have a meeting scheduled for next month in Boston, followed by meetings in Chicago and Washington, D.C. We have also scheduled an outreach meeting in Kansas City that will focus specifically on rural banking issues. Recognizing that travel costs may restrict the ability of interested parties to attend in person, we live-stream each outreach meeting, where possible, and provide a video archive of the proceedings to increase the public's opportunity to view the meetings. These resources are easily accessible on the agencies' EGRPRA website, as are the *Federal Register* notices, all comments we have received, and additional EGRPRA information.[2]

While the EGRPRA process will unfold over a period of time, the OCC will not wait until it is over to implement changes where a good case is made for regulatory relief. Where it is clear that a regulation is outdated, unnecessary, or unduly burdensome, we will act where we have the authority to do so. For example, we are actively reviewing suggestions to eliminate board of director approvals in certain circumstances and to broaden the use of electronic submissions for filing forms. In addition, many of the changes that we included in the integration rulemaking discussed above are consistent with comments we received in the EGRPRA review.

[2] The EGRPRA website can be accessed at http://egrpra.ffiec.gov.

Finally, the EGRPRA review may help us identify burdensome regulatory requirements that derive from statutory provisions. When we identify these provisions, we look forward to sharing our insights and experience with Congress.

Call Report Simplification. The OCC and other federal banking agencies, under the auspices of the FFIEC, are considering ways that we can further tailor reporting requirements for community banks. Recently, we received proposals to reduce the burden associated with the preparation of the Consolidated Reports of Condition and Income (Call Report), including the feasibility of allowing certain banks to file a short-form Call Report for two quarters of a year. The OCC has discussed the Call Report issue in numerous meetings with bankers, and we are committed to carefully considering their concerns.

As part of this effort, the OCC and other federal banking agencies have agreed to undertake a Call Report simplification project through the FFIEC Task Force on Reports. The first step was the development by the Task Force of guiding principles to serve as the basis for evaluating potential additions or deletions of data items to and from the Call Report. Using these guiding principles, the Task Force will undertake a comprehensive review of every line item of every schedule in the Call Report to identify data items that we can delete. The Task Force is also considering the feasibility of a simplified Call Report for certain community banks, as the current version includes schedules and data items not applicable to most of these institutions.

Collaboration. While we expect that the above-referenced projects will reduce burden for many community banks, the OCC is also studying other, less conventional approaches to help community banks thrive in the modern financial world. One especially promising approach involves collaboration between community banks and is the subject of an important paper the

OCC published earlier this year.[3] The principle behind this approach, which grew out of productive and on-going discussions between the OCC and our community banks, is that by pooling resources, community banks can manage regulatory requirements, trim costs, and serve customers who might otherwise lie beyond their reach. We have already seen examples of successful collaboration, such as community banks forming an alliance to bid on larger loan projects and banks pooling resources to finance community development activities.

There are many other opportunities of this nature, which can increase efficiencies and save money. As noted in our paper, these include collaboration on accounting, clerical support, data processing, employee benefit planning, and health insurance — to name just a few. Our innovative community banks can undoubtedly find other ways to share resources in a safe and sound manner.

V. Conclusion

Community banks are essential to our nation's communities and small businesses. The OCC is committed to minimizing unnecessary regulatory burden for these institutions. We will continue to consider carefully the potential effect that current and future policies and regulations may have on community banks and will be happy to work with the Subcommittee on any proposed legislative initiatives.

[3] *An Opportunity for Community Banks: Working Together Collaboratively*, Jan. 13, 2015.

Embargoed until April 23, 2015, 9:15 AM

TESTIMONY OF

CHARLES G. COOPER

BANKING COMMISSIONER

TEXAS DEPARTMENT OF BANKING

On behalf of the

CONFERENCE OF STATE BANK SUPERVISORS

On

EXAMINING REGULATORY BURDENS – REGULATOR PERSPECTIVE

Before the

FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

Thursday, April 23, 2015, 9:15 AM

HVC-210 Capitol Visitor Center

Embargoed until April 23, 2015, 9:15 AM

INTRODUCTION

Good morning, Chairman Neugebauer, Ranking Member Clay, and distinguished Members of the Subcommittee. My name is Charles Cooper. I serve as the Banking Commissioner for the Texas Department of Banking and I am the Vice Chairman of the Conference of State Bank Supervisors (CSBS). It is my pleasure to testify before you today on behalf of 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. Presently there are 6,423 federally insured banks. State banking regulators have chartered and now supervise 77 percent of these banks. In addition, state regulators also supervise a wide variety of non-bank financial services providers. For more than a century, CSBS has given state supervisors a national forum to coordinate supervision of their regulated entities and to develop regulatory policy. CSBS also provides training to state financial regulators and represents its members before Congress and the federal financial regulatory agencies.

I have more than 45 years of experience in the financial services industry – 12 as an FDIC bank examiner, 26 as a banker in both community and large banks, and now seven years as the Texas Banking Commissioner. Over these years, nothing has become more evident to me than the indispensable value of community banks. Community banks are vital to economic development, job creation, and financial stability of their local economies. Put simply, community banks are the backbone of thousands of communities across the country, and community banks play a foundational role in an increasingly diverse financial system. I appreciate the continued efforts of you and your colleagues to examine regulatory approaches for smaller financial institutions.

Over the past several years, many of Congress' regulatory reform efforts have rightfully addressed systemic problems presented by the nation's largest banks. However, there is widespread concern among state regulators, myself included, that the cumulative effects of existing and new regulations are creating an undue burden for many of the nation's community banks. When CSBS last testified before this Subcommittee just nine months ago, there were 6,665 banks, most of which are community banks. Today, there are 6,423 banks,[1] and that number continues to dwindle. While continued inquiry is necessary to understand to what extent regulatory burden is compelling these banks to consolidate, it is clear that the status quo is leading to fewer community banks for consumers with increasingly diverse financial needs.

State regulators are focused on right-sizing community bank regulation and supervision. Right-sized regulation does not necessarily mean fewer regulations, but rather means that regulations are tailored to the community bank business model.

Confronting the challenge of bank consolidation and crafting appropriate, right-sized regulations for community banks will require a more holistic approach to identifying and

[1] "FDIC Institutions Directory, Summary Statistics." Accessed April 20, 2015. Available at: https://www2.fdic.gov/idasp/index.asp

defining community banks. This is a high priority for state supervisors. Not only are state regulators responsible for the safety and soundness of our regulated entities, we are also charged with facilitating economic progress. In Texas, both state law and my Department's mission statement explicitly require us to increase economic prosperity and promote a competitive financial system. Put simply, state supervisors are uniquely positioned to promote right-sized regulation and supervision of banks consistent with their size, complexity, overall risk profile, and risk to the financial system.

My testimony today will highlight the importance of community banks and their relationship-lending business model. I will also discuss the value state regulators bring to their supervised institutions and their local economies, state regulators' efforts to right-size regulations for community banks and tackle emerging regulatory challenges, and the condition of state-federal regulatory coordination. Finally, my testimony will discuss specific ways in which Congress and the federal banking agencies can promote right-sized policy solutions for community banks.

COMMUNITY BANKS AND RELATIONSHIP LENDING ARE ESSENTIAL

The U.S. financial system is incredibly diverse, ranging from single-branch community banks to global financial conglomerates. This diversity is not a mistake, but rather a product of our unique dual-banking system. The dual-banking system, anchored by state and national banks chartered by state and federal regulators, has encouraged financial innovation and institutional diversity for more than 150 years.

Community banks are essential to the U.S. financial system and economy. The Federal Deposit Insurance Corporation (FDIC) classifies more than 92 percent of all U.S. banks as community banks, meaning there are 6,037 community banks embedded in local communities throughout the country.[2] The defining characteristic of a community bank is its relationship-lending business model – a business model that relies on the bank's knowledge of its local market, citizens, and economic conditions. This is why community banks have an outsized role in lending to America's small businesses, holding 45.3 percent of the banking industry's small loans to farms and businesses while only making up 13.2 percent of the banking industry's assets.[3] A community banker knows the entrepreneur opening a new business around the corner. A community banker also knows the local real estate market and the homebuyer seeking a mortgage loan. While a larger bank may reject a nontraditional borrower based on a predetermined model, a community banker's local knowledge allows him or her to offer personalized solutions designed to meet the specific needs of the borrower.

Community banks engage in relationship lending in the largest U.S. cities and the smallest rural markets. Their role in providing credit and banking services is just as vital as that of the largest financial institutions. In fact, many individuals and businesses are not particularly

[2] "Quarterly Banking Profile: Fourth Quarter 2014." FDIC. Available at: https://www2.fdic.gov/qbp/2014dec/qbp.pdf
[3] "FDIC Community Banking Study." FDIC, pp. 3-4 (December 2012). Available at: http://www.fdic.gov/regulations/resources/cbi/study.html

well-served by larger banks' standardized, model-driven lending. This is especially the case in rural areas, where the FDIC has found that community banks are three times more likely to operate a banking office outside of a metro area than their large bank counterparts.[4]

There are more than 600 counties – or one out of every five U.S. counties – that have no physical banking offices except those operated by community banks.[5] In Texas, there are four counties without a single banking office, 20 counties with only one bank office, and 113 of the state's 254 counties have five or fewer bank offices. The success of our community banks is instrumental to the success of the Texas economy: as research presented at the CSBS-Federal Reserve Community Bank Research conference shows, communities in which a community bank fails experience measurable drop-offs in economic performance, including lower income and compensation growth, higher poverty rates, and lower employment.[6]

Simply put, community banks are a vital part of a diverse financial services marketplace and help ensure credit flows throughout the nation's diverse markets. They provide credit and banking services in a flexible, innovative, and solutions-focused manner, characteristics that are inherent in the community bank relationship business model.

COMMUNITY BANKS NEED A RIGHT-SIZED REGULATORY FRAMEWORK

State regulators believe policymakers in Congress, the federal banking agencies, and state banking agencies must rethink how we all approach regulating and supervising community banks. The statistics are clear – most banks are community banks that operate in local markets.

Nearly 90 percent of today's 6,423 banks have less than $1 billion in total assets and hold less than 9 percent of the banking industry's total assets. On the other end of the industry spectrum, we find a very different type of bank: four U.S. banks exceed $1 trillion in total assets and hold around 42 percent of the banking industry's total assets.[7]

The community bank and megabank business model are also radically different. Community banks serve local economies by tailoring their loans and financial services around the customers within their geographically limited markets. Conversely, the largest banks leverage economies of scale in order to offer standardized mortgage and consumer products across a diversity of U.S. and global markets, provide financial services to multinational corporations, and engage in extensive capital markets activity.

These are vastly different businesses, and policymakers must regulate and supervise these financial institutions differently based on their size, complexity, overall risk profile, and risk to the financial system.

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[4] Ibid.
[5] Ibid.
[6] Kandrac, J. "Bank Failure, Relationship Lending, and Local Economic Performance." *Community Banking in the 21st Century Research Conference.* Federal Reserve System and the Conference of State Bank Supervisors, September 2013. https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2013/Kandrac_BankFailure_CBRC2013.pdf.
[7] FDIC Call Report data. https://www2.fdic.gov/Call_TFR_Rpts/.

Recent regulatory reform efforts have rightfully centered on addressing the problems posed by the largest, most systemically important banks. However, there is also widespread concern among policymakers and the banking industry that many of these new rules, in addition to existing regulatory requirements, pose an undue burden for community banks. Congress and federal regulators have undertaken measures to provide a right-sized regulatory framework for community institutions. While these efforts are positive, there remains a need for a much more comprehensive approach based on a common understanding of what constitutes a community bank. Appendix A of this testimony provides a list of asset-based regulatory relief provisions illustrating this point.

State regulators are concerned that an approach that relies solely or primarily on asset thresholds falls short in providing a right-sized regulatory framework for community banks that meaningfully distinguishes them from their larger competitors. True regulatory right-sizing for community banks will require a holistic approach.

State Regulators Support a Definitional Approach to Right-Sizing Community Bank Regulation

Regulatory right-sizing requires a process for determining how safety and soundness and consumer protection requirements can better reflect the community banking business model. To start this process, policymakers and regulators need to know which institutions should be the focus of our regulatory right-sizing efforts. To date, a consensus definition has eluded policymakers.

A definitional approach would provide the necessary foundation for a more appropriate regulatory framework for community banks. The definitional approach could be used as a basis for a broad range of regulatory right-sizing initiatives. With a new process in place to identify community banks, Congress and regulators could then move forward in a holistic manner to provide regulatory and supervisory right-sizing for these institutions.

Community banks are best identified by a set of principles that can be applied on a case-by-case basis, not by simple line drawing. CSBS is committed to getting this right, and my colleagues and I urge Congress to create a process for community bank identification that is not solely based on asset thresholds, but takes qualitative criteria into account. For example, state regulators believe characteristics such as the following can help identify community banks:

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

A definitional approach such as this will provide the necessary framework for policymakers to better align community bank regulation with the community bank business model, a concept that state regulators refer to as "right-sizing" community bank regulation.

STATE REGULATORS PLAY A VITAL ROLE IN REGULATORY RIGHT-SIZING

State regulators have a long history of innovating to improve our regulatory and supervisory processes to better meet the needs of banks, their customers, and our states. Many bank products and services that now seem commonplace evolved as a result of the regulatory flexibility fostered by the dual-banking system. This regulatory flexibility is a strength of the state banking system. After all, community banks in Texas might face local issues that my department should address in one manner, while another state's banking regulator might have a different set of supervisory challenges to address.

State Agencies Strive For Supervisory Efficiency and Excellence

State regulators supervise a diverse range of depository and non-depository institutions, many of which are unique in their composition, size, and overall risk profile. The Texas Department of Banking supervises 263 depository financial institutions. The Department supervises more of our state's financial institutions than any federal regulatory agency, a fact that holds true for most state banking departments. Most state banking departments also regulate a variety of non-bank financial service providers, including mortgage lenders, mortgage servicers, and money services businesses. Beyond state-chartered banks, the Texas Department of Banking also supervises other businesses including money service businesses, trust companies, and foreign bank agencies.[8]

Having such a diverse and multifaceted number of supervisory responsibilities means that state agencies must retain highly-skilled, specialized staff for examinations and supervision. Of the over 140 examiners in the Texas Department of Banking, we have examiners specialized in Information Technology examinations, Trust examinations, Capital Markets examinations, and Bank Secrecy Act (BSA) examinations. For all of our supervised industries, state regulators adhere to a philosophy that supervision must be tough, but also fair, an approach that ensures appropriate but effective examination procedures.

To ensure our Department maintains high-level standards for our examinations, our staff attends a series of national schools presented by the federal regulatory agencies and CSBS. CSBS offers cutting edge training and certification opportunities on topics like lending principles, operations and deposits, and fair lending examination techniques. This training is supplemented by intensive on-the-job training, as well as advanced and specialty training designed by our Department and specifically tailored to meet the needs of Texas institutions. State examiners across the nation are committed to meeting the needs of their local communities, and the state-of-the-art training provided by CSBS and individual departments reflects that commitment.

[8] The Texas Department of Banking also supervises check verification companies, private child support companies, funeral contract sellers, perpetual care cemeteries, and cemetery brokers.

Just as thorough training enhances the professionalism of the state examiner workforce, a rigorous accreditation program, administered by CSBS, enhances the standards by which states fulfill their supervisory responsibilities. The Texas Department of Banking has been accredited by CSBS since 1993, signifying that my Department has maintained the highest standards and practices in banking supervision.

Highly-trained, locally-accountable examiners who are keenly aware of the needs of their local community are a hallmark of the state banking system. Their innovative and tailored approach to supervision provides value to their chartered institutions, their constituents, and the financial system as whole.

State Regulators Promote Research and Dialogue on Community Banking

Equally important as having the necessary professional training and proper supervisory tools at their disposal, state regulators recognize that designing a right-sized regulatory framework requires truly understanding the state of community banking, the issues community banks face, and the nuances within the community banking industry. Data-driven and independently developed research on community banks is sorely lacking when compared to the breadth of research dedicated to the nation's largest financial institutions.

To address the need for research focused on community banks, state regulators, through CSBS, have partnered with the Federal Reserve to conduct the annual Community Banking in the 21st Century Research Conference.[9] Bringing together state and federal regulators, industry experts, community bankers, and academics, the research conference provides valuable data, statistics, and analysis about community banking. Our hope is that community bank research will inform legislative and regulatory proposals and appropriate supervisory practices, and will add a new dimension to the policy dialogue about community banks.

The conference represents an innovative approach to research. The industry recommends many of the themes studied, providing their perspective on issues through a national survey and local industry roundtables. At the same time, academics explore issues in a neutral, empirical manner, while also contributing their own independent research topics. This approach ensures that three research elements – quantitative survey data, qualitative town hall findings, and independent academic research – all enhance and refine one another, year after year. The research conference's early success underscores the interest and need for community bank research: in 2014, more than 1,000 community bankers participated in the national survey, more than 1,300 bankers attended local town hall meetings, and more than 37 research papers were submitted by academics for consideration, a considerable increase from the number of papers submitted for the inaugural 2013 conference.

Some of the findings of the conference and the research initiatives surrounding the conference are detailed in Appendix C. The third annual Community Banking in the 21st Century Research Conference will occur September 30 and October 1, 2015, at the Federal

[9] "Community Banking in the 21st Century." Federal Reserve System/CSBS. Available at: https://www.stlouisfed.org/banking/community-banking-conference-2015/

Reserve Bank of St. Louis.[10] We are pleased that Federal Reserve Chair Yellen will be attending and delivering the keynote address.

Promoting Executive Leadership of Cybersecurity

The persistent threat of cyber-attacks is a global problem that threatens all industries, especially the financial services industry. We appreciate Congress' ongoing efforts to address cybersecurity challenges. Cybersecurity is a national priority, and state regulators are focused on ensuring that banks have the necessary information and the appropriate tools to address this vital issue. State regulators have heard from community bank executives that, while they understand the harm cyber-attacks can cause to their financial institutions, the abundance of information available on cybersecurity is overwhelming and largely technical, making many bankers uncertain as to what information applies to their particular institution.

This prompted state regulators, through CSBS, to launch the Executive Leadership of Cybersecurity (ELOC) initiative in 2014.[11] The ELOC initiative seeks to raise awareness among bank CEOs that managing an institution's cybersecurity risks is not just a "back office" issue, but also an executive and board level issue. ELOC is part of a larger state and federal effort through the FFIEC to help combat the threat of cyber-attacks in the financial services sector.

The launch of the ELOC initiative included a nine-week educational outreach effort. From that outreach, more than 500 community bankers signed up to receive CSBS's exclusive *Cyber 101: A Resource Guide for Bank Executives*,[12] a resource guide that compiles recognized industry standards for cybersecurity and financial services industry best practices into one booklet. The ELOC outreach campaign and resource guide provided community bank executives with the knowledge and necessary tools to better understand cyber threats at their institutions, better prepare for and protect against cyber threats, and to better understand their role as bank executives in managing cybersecurity risks at their banks. The high level of community banker interest in the ELOC initiative sent a strong message to state regulators that community banks are looking for more leadership and clear guidance on how to manage cybersecurity risks at their institutions.

In addition to the ELOC website and the cyber resource guide, CSBS is working with state banking departments to host a series of cybersecurity industry outreach events throughout 2015. Having worked with Texas community banks since 2010 on cybersecurity issues like Corporate Account Takeover (CATO), the Texas Department of Banking was pleased to partner with the Texas Bankers Association, Independent Bankers Association of Texas, the Southwestern Automated Clearing House Association (SWACHA), and law enforcement to hold the inaugural ELOC summit in Austin, Texas in December 2014. The summit brought together more than 300 bank CEOs, senior executives, and board members to learn about the current

[10] https://www.stlouisfed.org/Bank-Supervision/2015-Community-Banking-Conference.
[11] "Executive Leadership of Cybersecurity." CSBS. Available at: http://www.csbs.org/cybersecurity
[12] http://www.csbs.org/CyberSecurity/Documents/CSBS%20Cybersecurity%20101%20Resource%20Guide%20FINAL.pdf.

cyber threat landscape, best practices for managing cybersecurity, and information sharing resources.

ELOC and initiatives like it provide direct, tangible value to community banks. All banks face an enormous challenge in securing their systems against a growing number of cyber threats, and state regulators are providing valuable tools to mitigate cybersecurity risks.

States Enhance Non-Depository Supervision through NMLS

Effective supervision of such a diverse financial landscape requires that state regulators have all the necessary supervisory tools at their disposal. To help meet this need and ensure the most effective collaboration between one another, state regulators developed the Nationwide Multi-State Licensing System and Registry (NMLS or the System). NMLS is a powerful tool for state regulators. In 2006, state regulators began developing NMLS as the "back office" for state licensing and supervision of mortgage loan originators (MLOs), allowing state regulators to quickly and efficiently conduct background checks on license applicants, have access to a nationwide database of licensed MLOs and companies, and safely share information with one another. The System also provides for increased efficiency for license applicants and the industry as a whole, as licensees are able to submit their applications through a single, uniform application system.

Congress recognized the benefits of a unified system for mortgage licensing, and as such codified the NMLS into federal law as part of the 2008 Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). As the System became more ubiquitous and more efficient, the states expanded their use of the System to include licensing a broad range of non-bank financial services industries including money transmitters, consumer finance lenders, check cashers, debt collectors, and payday lenders.

State regulators commend the House for passing H.R. 1480, a commonsense bill that supports state regulators' expanded use of NMLS as a licensing system without the loss of privilege or confidentiality protections provided by state and federal laws, and we encourage swift passage of the bill into law.

As states continue to expand their use of NMLS as a licensing and regulatory system, we continue to seek ways to enhance efficiencies that the System provides for regulators and for regulated entities. One such area is the processing of background checks through NMLS. Many state laws require background checks as part of the licensing process in certain financial services industries. In the case of mortgage loan originators, the SAFE Act enables NMLS to obtain a criminal background history from the Federal Bureau of Investigations in 24 hours, a process that used to take several weeks or months. State regulators would like to bring this same efficiency to licensing in other non-bank financial services industries processed through NMLS.

Accomplishing this goal requires legislation. State regulators began working with Congress last year on a change to the SAFE Act that would explicitly authorize NMLS to process criminal background checks for non-depository licensees beyond MLOs when state law requires such a background check. By authorizing NMLS to receive criminal background data

for financial services providers beyond the mortgage industry, this proposal enhances consumer protection, reduces regulatory burden, and ensures state regulators have the tools they need for effective supervision. We hope the Subcommittee and the full Committee will support this effort.

While NMLS focuses on licensing non-bank financial service providers, the System provides increased collaboration between state banking departments, reduces the risk of bad actors continuing financial services operations, and improves the safety and soundness of the financial system as a whole. In short, NMLS provides an added level of assurance to community banks that their business customers and vendors are operating legally, and an added level of assurance to consumers that their financial service providers are subject to regulatory accountability.

The states' work on examiner training, community bank research, cybersecurity awareness and preparedness, and use and expansion of the NMLS all demonstrate state regulators' commitment to seek innovative solutions and methods to provide comprehensive and effective supervision. Financial institutions should be in the business of supporting their communities, and state regulators make every effort possible to create a responsive, dynamic regulatory framework that allows our supervised financial institutions to do just that. We are working to achieve supervision that ensures safety and soundness and consumer protection, while allowing these institutions to serve their customers most effectively and contribute to the success of our local communities, our states, and our nation.

More examples of how state regulators are working to right-size regulations for community banks are included within this testimony's Appendix B. For a comprehensive discussion of states' work in regulatory right-sizing for supervised entities, please refer to "An Incremental Approach to Financial Regulation," [13] and "The Public Benefit of State Financial Services Regulation,"[14] CSBS white papers published in December 2013 and January 2015, respectively.

STATE REGULATORS WORK CLOSELY WITH OUR FEDERAL COUNTERPARTS

State regulators do not work in isolation. One of the key strengths of the dual-banking system is the ability to leverage the specific advantages of state and federal regulatory agencies: while state agencies have the ability to provide flexibility and address specific, localized issues, federal agencies provide a platform through which emerging trends or threats can be addressed on a national scale. This state-federal partnership, known as "cooperative federalism," leverages the strengths of both state and federal regulators.

This cooperative federalism has resulted in strong relationships among state and federal regulators. Cooperative federalism is well-established in banking, as states have worked for decades with the FDIC, the Federal Reserve, and the Office of the Comptroller of the Currency

[13] http://www.csbs.org/legislative/testimony/Documents/An%20Incremental%20Approach%20to%20Financial%20Regulation.pdf.

[14] http://www.csbs.org/news/csbswhitepapers/Documents/The%20Public%20Benefit%20of%20State%20Financial%20Services%20Regulation.pdf

(OCC). With both depository and the non-depository institutions, state regulators coordinate with the Consumer Financial Protection Bureau (CFPB).

Cooperative Agreements between State and Federal Regulators

Banking law over the past several decades – including the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA), the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal),[15] the Riegle-Neal Amendments Act of 1997 (Riegle-Neal II), and more recently the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[16] – has reflected a robust statutory mandate of coordination and cooperation between state and federal financial regulators. These legal requirements are buttressed and delineated in a series of agreements the states have signed with federal financial regulators.

State/Federal Supervisory Agreements

The 1996 Nationwide State/Federal Supervisory Agreement and accompanying State/Federal Supervisory Protocol[17] established a framework for coordinated examinations and enforcement. The agreement and protocol was signed by all 50 state banking departments, the FDIC, and Federal Reserve Board (FRB or the Board) in 1996. The goals of the agreement are to provide for a seamless supervisory process, to ensure that supervision is flexible and risk-focused, and to minimize regulatory burden and costs for covered institutions. While the nearly 20 year old agreement was developed to respond to the supervisory challenges stemming from interstate branching, the goals and principles that it contains are even more important in today's complex and continuously evolving banking environment.

The 1996 agreement recognizes an institution's consumer compliance functions have a critical impact on its safety and soundness. The agreement provides the required foundation for coordination between the states and the federal agencies on compliance examinations, and represents a spirit of cooperation and coordination that has served the dual-banking system well.

CSBS-CFPB Memorandum of Understanding

In 2011, state regulators, CSBS and the CFPB signed a memorandum of understanding (MOU) establishing a foundation of state and federal coordination on consumer protection supervision of financial service providers.[18] The MOU seeks to regulatory burden while ensuring consumer protection by promoting consistent examination procedures and effective enforcement of state and federal consumer laws. The MOU also provides that state regulators and the CFPB will consult each other regarding the standards, procedures, and practices used by state regulators and the CFPB to conduct compliance examinations.

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[15] Section 105 (amending 12 U.S.C. § 1820)
[16] Section 1015 (12 U.S.C. § 5495)
[17] http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/nationwide_state_fed_supervisory_agrmnt.pdf.
[18] http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/CFPB%20CSBS%20MOU.pdf.

Based on the MOU, CSBS and the CFPB signed in 2013 a supervisory coordination framework further establishing the process for how state regulators and the CFPB will coordinate supervision of non-depository financial service providers and covered depository institutions with more than $10 billion in assets. Much like the 1996 State/Federal Supervisory Agreement, this framework provides for a coordinated supervisory system for those providers regulated jointly by CFPB and the states.

State regulators are represented in the framework through the State Coordinating Committee (SCC), a body comprised of two representatives from each of the six state financial regulatory associations.[19] The SCC is responsible for acting as a voice of leadership on behalf of state regulators and the state non-depository supervision system, advancing supervisory and regulatory policy among state regulators and their federal counterparts.

State regulators commend Congress for including language in Title X of the Dodd-Frank Act that requires this collaboration with the CFPB. The MOU and framework allow for regulators to implement a flexible, dynamic process that helps achieve efficiency in examination and avoid duplication of time and resources.

State Regulators and the Financial Stability Oversight Council (FSOC)

FSOC was established by the Dodd-Frank Act to identify risks to the financial stability of the United States, to promote market discipline by eliminating expectations that the U.S. government would shield financial institutions from losses in the event of failure, and to respond to emerging threats to the stability of the U.S. financial system.

State regulators commend Congress for requiring that FSOC include as a nonvoting member a state banking supervisor as chosen and designated by their colleagues. Providing state regulators a "seat" at this table has enhanced regulatory coordination and informed state efforts to address potential emerging risks.

For example, the 2014 FSOC Annual Report identified non-bank mortgage servicing as an area requiring heightened risk management and supervisory attention and recommended state regulators work with the CFPB and Federal Housing Finance Agency (FHFA) to establish prudential standards. In response, state regulators, through CSBS, launched the Mortgage Servicing Rights Task Force[20] to evaluate options for prudential regulatory standards for non-bank mortgage servicers.

[19] American Association of Residential Mortgage Regulators (AARMR), CSBS, the Money Transmitter Regulators Association (MTRA), the National Association of Consumer Credit Administrators (NACCA), the North American Collection Agency Regulatory Association (NACARA), and the National Association of State Credit Union Supervisors (NASCUS).

State-Federal Coordination through the Federal Financial Institutions Examination Council

CSBS and state regulators play a major role in the efforts of the Federal Financial Institutions Examination Council (FFIEC or Council). In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC was established to incorporate the state supervisory perspective into the FFIEC and to make recommendations to promote uniformity in the supervision of financial institutions at the state and federal level. The SLC includes representatives from CSBS, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

Through the FFIEC, state regulators coordinate with their federal counterparts on a whole host of supervisory issues. One example among many is the collaborative work the FFIEC has undertaken in the realm of cybersecurity. Like my Department's work on Corporate Account Takeovers (CATO) and CSBS's outreach to bank executives, the FFIEC is taking proactive steps to mitigate cybersecurity threats in the financial services industry.

In March, the FFIEC provided an overview of its cybersecurity priorities for the remainder of 2015. The planned work includes the development and issuance of a self-assessment tool that financial institutions can use to evaluate their readiness to identify, mitigate and respond to cyber threats. The FFIEC also will enhance their incident analysis, crisis management, training, and policy development and expand their focus on technology service providers' cybersecurity preparedness.

When the FFIEC can rally around an issue like cybersecurity and deliver real value to the industry both in terms of awareness and practical tools to mitigate risk, the entire financial services industry becomes a safer, more effective place to do business.

Economic Growth and Regulatory Paperwork Reduction Act

Another area where the FFIEC is engaging in partnerships to improve the health of the financial industry is through the review of banking regulations mandated by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). State regulators, through our membership on the FFIEC, are committed to using this review as an opportunity to pinpoint regulations that may not be properly suited to the business model of community banks. We are participating in this process through the FFIEC with our federal colleagues at the FDIC, FRB, and OCC.

State regulators are attending and participating in the regional outreach events. State regulators are particularly pleased that there will be an event later this year in Kansas City focused on rural banks. Additionally, the feedback received during the outreach events and through the ongoing comment process will provide important input to the State Liaison Committee and state regulators as a whole as we continue to seek ways to minimize duplicative regulation and to make supervision of state-chartered banks more efficient.

The FFIEC and federal regulatory agencies are contributing significant time and resources to ensure the EGRPRA process is a fruitful endeavor. The federal regulators'

commitment to this effort is evidenced by the attendance of Comptroller Curry, Federal Reserve Governor Powell, and FDIC Chairman Gruenberg at EGRPRA outreach meetings throughout the country. Their commitment will help make this a meaningful process of reducing regulatory burden.

While the comment process and outreach events have just begun, they are already yielding meaningful areas for us to consider changes, including burdens associated with the quarterly call report, other regulatory filings, and BSA compliance. The industry is also building a reasonable case for extending the examination cycle for certain institutions. We also greatly appreciate Comptroller Curry's and Governor Powell's comments that there are changes we can start making now before we complete the EGRPRA process.

State regulators are also encouraged by the possibility that Dodd-Frank regulations could be considered as part of the EGRPRA process. It makes sense to review the regulations contained within Dodd-Frank in the same way all other regulations are reviewed. State regulators welcome any steps that can be taken to eliminate inappropriate or unduly burdensome regulation.

Examination Tools

The state banking departments, through CSBS, enjoy a strong partnership with the FDIC and Federal Reserve in the development and use of interagency examination tools. Coordinated supervision depends on consistent processes and uniform tools. Providing uniform technology tools for examinations promotes a consistent, standardized supervisory process across state and federal regulators. This ultimately leads to a more coordinated supervisory approach that is clear, efficient, and concise, thus reducing regulatory burden on the supervised institutions.

AREAS OF IMPROVEMENT FOR STATE-FEDERAL COORDINATION

The examples of successful coordination between state and federal regulators all share one common feature: from the outset, state and federal regulators were regularly engaged with one another, communicating their needs and interests, and considering the best possible outcome based on the input of all involved parties. As I mentioned before, regulatory burden stands the greatest chance of being reduced when all parties work together.

Additionally, while statutory and other requirements are helpful in providing a framework, coordination is most effective when the leadership of state and federal agencies is committed to a culture of cooperation and collaboration. The examples above are occasions where such a culture has succeeded.

With these notions in mind, state regulators feel there are certain areas where state-federal coordination could be improved.

Improving Coordination of Compliance Examinations

The 1996 State/Federal Supervisory Agreement provides the required foundation for coordination between the states and federal regulators on compliance examinations. A growing number of states desire the option to conduct alternating or joint compliance examinations. A coordinated and joint approach to examinations, reports of examination, regulatory actions, and enforcement orders would result in more coordinated and efficient supervision.

State regulators are currently working with the Federal Reserve on how to more effectively coordinate on compliance exams. State regulators value their working relationship with the Federal Reserve and are committed to the collaborative principles outlined in the 1996 Agreement. Coordinated compliance supervision reduces regulatory burden and encourages states to fully participate in this critically important space.

Improving Collaboration and Coordination on Rulemakings

While our agreements with the various federal financial regulators and state regulators' role on the FFIEC provide important avenues for coordination and information sharing, the federal agencies' processes for drafting federal rules does not have any mechanism for state regulators to have a view into rules in progress. As a result, state regulators are left to discover through the federal register rules that impact institutions they charter.

State banking regulators participation in the FSOC has provided us with valuable insight and perspective. CSBS asks for Congress' help in developing a mechanism for providing state regulators with this same insight and perspective when it comes to the development of federal regulations affecting our regulated institutions.

Preserving a Thriving Dual-Banking System

The 1996 State/Federal Supervisory Agreement is just one example of how, for more than 150 years, the United States has gone to great lengths to promote the uniquely American dual-banking system, with national banks chartered and supervised at the federal level and state banks chartered and supervised at the state level. The dual-banking system is a primary example of the government's longstanding intent on U.S. financial diversity, innovation, and dynamism. In addition to state-chartered banks, state regulators license, credential, and supervise a variety of non-depository financial services companies. These state-regulated, non-depository financial services providers add another layer of diversity to the U.S. financial system.

The dual-banking system, and the checks and balances it creates between the federal and state systems, has been foundational to the country's economic success. Historically, national banks brought the benefits of uniformity to the U.S. banking system since they operated under a uniform set of federal standards. On the other hand, state banks operating under local standards contributed flexibility, diversity, and innovation to the U.S. banking system. Time has shown that both sides of the dual-banking system provide benefits to the economy.

As of late, there has been increased interest by some pundits in Washington to consolidate the financial regulatory agencies. Debate about improving the existing regulatory structure is healthy and can result in positive reforms. However, this idea is not new, and this discussion has already occurred several times.[21] In the wake of nearly every recession, pundits have called for the consolidation of supervisory authority and the creation of a behemoth federal regulatory agency. When these plans are actually deliberated, however, policymakers have intentionally declined to consolidate supervision under a single federal regulator. Instead, policymakers have consciously chosen to preserve, and sometimes even enhance, the checks and balances of the dual-banking system.

Recent proposals would charge a newly-created monolithic and unadaptable agency with supervising the most dynamic and diverse financial services industry in the world. The dual-banking system is well-equipped to supervise an innovative financial services industry and should be preserved.

SPECIFIC RECOMMENDATIONS FOR COMMUNITY BANK REGULATORY RIGHT-SIZING

As the effort to address a right-sized regulatory framework has evolved over the last several years, state regulators have worked to identify specific recommendations that we believe would be meaningful for community banks. As state regulators, we believe that finding a right-sized regulatory balance does not necessarily mean fewer regulations, but rather means that regulations are appropriately targeted, properly balanced, and prudently implemented. While I provide individual recommendations for the regulatory issues presented below, the definitional approach to identifying community banks I discussed earlier would provide the foundation to address many of these issues.

Study Risk-Based Capital for Smaller Institutions

The Basel Committee on Banking Supervision designed risk-based capital standards for internationally active banks. These standards are overly complex and inappropriate for community banks and their business model. Indeed, research presented at the Community Banking in the 21st Century Research Conference has shown that a simple leverage requirement would be equally, if not more, effective than risk-based capital requirements for community banks, and would be much less burdensome.[22]

Congress should mandate the U.S. Government Accountability Office (GAO) investigate the value and utility of risk-based capital for smaller institutions. The resulting GAO study should seek to understand how risk weights drive behavior in the volume and type of credit a bank originates, as well as the burden of providing the necessary data for calculating capital ratios.

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[21] Similar suggestions were raised in the Bloomberg-Schumer Report, the Paulson Plan, and the Geithner White Paper.

[22] Moore, R., and M. Seamans. "Capital Regulation at Community Banks: Lessons from 400 Failures." Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2013/Capital_Regulation_at_Community_Banks.pdf.

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Mortgage Rules Should Better Reflect the Realities of Community Bank Portfolio Lending

Community banks that hold the full risk of default of a loan are fully incented to determine the borrower's repayment ability. Laws and regulations regarding mortgage lending should reflect this reality.

Qualified Mortgage Status for Mortgages Held in Portfolio

State regulators have long supported a flexible approach to underwriting for institutions that retain mortgages in portfolio because interests are inherently aligned between consumers and lenders that retain 100 percent of the risk of default. When the consumer defaults, portfolio lenders are incentivized to work with the borrower to fix the problem.

Yet, a national community bank survey and community bank town hall meetings conducted in conjunction with the 2014 Community Banking in the 21st Century Research Conference point to a problem: while many community banks' existing mortgage businesses are consistent with the Ability-to-Repay (ATR) and Qualified Mortgage (QM) requirements, community bankers report that the regulation is creating an outsized burden.

One solution that would tailor the requirement to the nature of community bank mortgage lending is to grant the QM liability safe harbor to all mortgage loans held in portfolio by a community bank. Congress explored this issue through hearings and CSBS-supported legislation during the 113th Congress. While broader in scope, legislation has been introduced this Congress addressing this issue (H.R. 1210). We encourage this Congress to pursue similar legislation to promote portfolio lending by community banks.

Improving the CFPB's Rural Designation Process

The Dodd-Frank Act's ATR requirement's restrictions on balloon loans and the CFPB's efforts to provide limited relief for balloon loans made by smaller institutions in rural areas illustrate the need for regulatory right-sizing and for a conscious effort to understand and adapt regulation to the community bank business model. When used responsibly, balloon loans are a useful source of credit for borrowers in all areas. Properly underwritten balloon loans are tailored to the needs and circumstances of the borrower, including situations in which the borrower or property is otherwise ineligible for standard mortgage products.

As a regulator, I prefer that lenders and borrowers in my state have flexibility and options when selecting consumer products and mortgages. Since the mortgage is held in portfolio, community banks must work to ensure that the loan terms take into consideration all risks associated with the borrower in order to avoid default.

Community banks retain balloon mortgages in portfolio as a means of offering credit to individuals that do not fit a standard product but nonetheless can meet the monthly mortgage obligation. That is the logic behind the Dodd-Frank Act provision providing balloon loans with QM status if those loans are originated in rural or underserved areas by a small creditor. However, the CFPB's original approach to identifying such areas relied solely on the Department

of Agriculture's Urban Influence Codes, producing many illogical and problematic outcomes for community banks.

CSBS raised this concern shortly after the original rule was proposed, and we worked with Congress to develop a petition process for interested parties to seek rural designation. We applaud Congress for its focus on this issue, and we appreciate the CFPB's recent efforts to improve its rural and underserved designation framework by adding rural census blocks as defined by the U.S. Census Bureau. While a welcome step, the CFPB rule still lacks the sufficient flexibility to capture the geographic and demographic diversity of the United States.

More fundamentally, portfolio lending is not a "rural" issue or an "underserved" issue; it is a relationship lending issue for all community banks. Accordingly, we support legislation creating a petition process for CFPB rural designations (H.R. 1259 and S. 871). This legislation passed the House by voice vote in the previous 113th Congress. The 114th Congress passed the bill by an overwhelming bi-partisan vote on April 13, 2015, and we hope this measure can quickly pass the Senate and be signed into law.

Tailor Appraiser Qualifications for 1-4 Family Loans Held in Portfolio

Current appraisal regulations can curtail mortgage lending in markets that lack qualified appraisers or comparable sales. Congress should require regulations to accommodate portfolio loans for owner-occupied 1-4 family loans, recognizing the lender's proximity to the market and the inherent challenge in securing an accurate appraisal by a qualified appraiser.

Fair Lending Supervision Must Acknowledge the Community Bank Business Model

State regulators take the difficulties that many underserved borrowers have had in obtaining access to credit very seriously, especially in regard to mortgage lending and homeownership. State regulators are committed to the enforcement of fair lending laws, but we are concerned about regulators' overreliance on opaque statistical models that use small samples to judge fair lending performance. Many times it is not the statute that creates the problem, but the interpretation, guidance, and the examination techniques utilized. Federal agency leadership must commit to a more pragmatic and transparent approach to fair lending supervision. Specifically, the federal bank regulatory agencies should share their fair lending models and examination methodologies with the industry to provide greater transparency and reduce uncertainty about the process.

Federal regulators should not use one-size-fits-all techniques in fair lending examinations. Smaller institutions make case-by-case lending decisions based on local knowledge. While statistical analysis plays a role in fair lending supervision, it should not be the beginning and end of the analysis. Supervisors must utilize their flexibility to look beyond statistical models to take a more complete view of the lending decision or the result will be the continued standardization and commoditization of consumer credit in this country.

The current approach to fair lending for community banks is having a chilling effect on credit availability as banks become frustrated by the examination process. I am concerned that this approach may be causing community banks to curtail or exit certain consumer credit products. From a public policy perspective, we should want community banks doing this business.

The Application Process for Community Banks Must Reflect the Business Model

Community bank applications submitted to federal banking agencies for transactions such as mergers and capital investments can take an extended time to process because the agencies have to ensure the decision will not establish a precedent that could be exploited by larger institutions. The approval of a merger, acquisition, or expansion of activities should be related to the overall size and complexity of the transaction, and community banks should not be unnecessarily penalized for the potential action of larger financial institutions. Federal law, an agency rule, or a clause in an approval letter could provide the necessary protection by stating that application decisions for community banks do not establish a precedent for systemically important financial institutions.

To further address the length of time the agencies take to review community bank applications, the application review and approval process for a defined subset of community institutions should be de-centralized with more final decision-making authority given to FDIC Regional Offices and the regional Federal Reserve Banks.

Federal Regulatory Agency Leadership and State Supervisory Representation

A key to the success of the dual-banking system is robust coordination among regulators. Meaningful coordination in regulation and supervision means diversity at the highest governance levels at the federal regulatory agencies. The current FDIC Board does not include an individual with state regulatory experience as required by law. The Federal Deposit Insurance (FDI) Act and congressional intent clearly require that the FDIC Board must include an individual who has worked as a state official responsible for bank supervision. As the chartering authority for 77 percent of all banks in the United States, state regulators bring an important regulatory perspective that reflects the realities of local economies and credit markets. State regulators were pleased to see bi-partisan legislation introduced last Congress in the Senate and the House that refined the language of the FDI Act to ensure that Congress' intent is met and that the FDIC Board includes an individual who has worked in state government as a banking regulator. We are again pleased the proposal has been re-introduced this Congress (H.R. 1601).

We also thank Congress for passing legislation requiring community bank or community bank supervisory representation on the Federal Reserve Board of Governors through the Terrorism Risk Insurance Program Reauthorization Act of 2014. Passage of Senator Vitter's provision reinforces Congress' intent to bring together a range of perspectives on the Board, and reaffirms the important role of community banks in the financial marketplace.

Practical Privacy Policy Notice Requirements

State regulators firmly believe that financial institutions have an affirmative and continuing obligation to respect customer privacy. However, there are commonsense practices for communicating privacy policies. If a bank's privacy policy does not change, the bank should not be required to repeatedly inform customers of the policy. Redundant notifications are costly and limit the effectiveness of important privacy communications with customers. Accordingly, CSBS supports any fix to the Gramm-Leach-Bliley Act that exempts financial institutions from mandatory annual privacy policy mailings if the institution's privacy policy does not change. State regulators commend the House for passing H.R. 601, the Eliminate Privacy Notice Confusion Act, a bill that provides such an exemption to financial institutions, and we encourage swift passage of the bill into law. We encourage the Senate to act on this measure.

Improvements to the Call Report

Call Report data is a vital component of effective supervision. Call Report data allows regulators to quickly identify red flags in a single bank's balance financials as well as analyze emerging risks in the greater financial marketplace. While the benefits of this data are clear, so too are the burdens borne by community banks in delivering this data to regulators. It is important that regulators remain mindful of these burdens and work to eliminate unnecessary burden throughout the Call Report.

CSBS supports efforts to reduce regulatory burden associated with Call Report preparation, including the efforts of the FFIEC to evaluate the specific components of the call report. CSBS believes it is important that regulators fully understand the problems presented by community bankers concerning the Call Report at a very granular level, specifically the manual effort required to gather and provide information for certain Call Report schedules.

VIEWS ON SPECIFIC LEGISLATIVE PROPOSALS

The House Financial Services Committee and the Senate Banking Committee, through a series of hearings over multiple Congresses, have thoroughly illustrated how regulation and supervision are negatively impacting the community banking business model. These hearings have built momentum for reform, and several reform items are now pending before the Committee. In addition to those legislative proposals discussed above, this section provides state regulators' perspectives on certain other proposals pending before Congress.

Reforming Exam Procedures

State regulators have heard concerns from community bankers about the examination process. Various legislative proposals have been introduced to reform the exam process.

State regulators, because of our proximity to the institutions we regulate, frequently have a more local understanding and appreciation of the unique characteristics of the institutions we supervise. This local knowledge and decision-making helps inform the state examination

process and make it stronger. Moreover, local decision-making expedites many processes and typically leads to quicker return times for exam findings.

State regulators support the OCC model of an Ombudsman who operates outside bank supervision channels and, with the consent of the Comptroller, may supersede OCC decisions or actions during the resolution of an appealable matter. We encourage other federal bank regulators to consider the merits of this model.

Changes to the Exam Cycle

In addition to reforming the exam process, there are proposals to lengthen the exam cycle to 24 months and to raise the threshold for banks eligible for an 18 month exam cycle.

While state regulators are aware of complaints about the federal exam process, complaints tend to center around the nature of the exam rather than the exam cycle. Exams need to be more focused on the risks institutions pose and better tailored to the business model of the institution. State regulators are concerned about our ability to fulfill our responsibilities as regulators of safety and soundness with a lengthier exam cycle. In addition, a 24 month exam cycle would exceed the limit imposed by some states' laws.

Federal law provides for an 18-month exam cycle for banks having $500 million or less in assets that are well capitalized, well managed, has a composite condition ratio of Outstanding, and has no formal enforcement actions.[23] The OCC has testified in support of raising the threshold to $750 million.[24] There is a Congressional proposal to raise the threshold to $1 billion (H.R. 1553). While we have not taken a formal position, raising the threshold to $750 million or $1 billion would be a welcome step. Since institutions of $1 billion or less do not pose the same risks as larger institutions, an 18 month exam cycle is entirely appropriate for these institutions.

MOVING FORWARD

State regulators are uniquely capable of right-sizing regulation for the relationship-lending business model of community banks and leading in the supervision of non-depository financial service providers.

Establishing a new definitional approach for identifying community banks is essential to creating a regulatory framework that supports the community bank relationship lending model. Providing legal authority to state regulators to process criminal background checks through NMLS for all non-depository financial service providers is a necessary step toward creating a dynamic, effective regulatory system that works well for non-depository institutions and their consumers. And, in order for the dual-banking system to maintain its strategic advantages, state and federal regulators must remain committed to a culture of collaboration.

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[23] 12 USC 1820(d)(4).

[24] United States. Cong. Senate. Committee on Banking, Housing and Urban Affairs. *Regulatory Relief for Community Banks and Credit Unions.* Hearings, February 10, 2015. 114th Congress. 1st Session.
3. 15 U.S.C. § 1639c(b)(2)(E)(iv)(I).

CSBS remains prepared to work with members of Congress and our federal counterparts to right-size regulations, ensure effective supervision of non-bank institutions, and promote our common goals of safety and soundness and consumer protection.

Thank you again for the opportunity to testify today, and I look forward to answering any questions you may have.

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APPENDIX A

Differing Asset Thresholds for Small Bank Exemptions

- Federal Reserve Small Bank Holding Company (BHC) Policy Statement – Exempts BHCs with assets less than $1 billion from the consolidated BHC capital guidelines and grants them simplified reporting requirements.

- Consumer Financial Protection Bureau (CFPB) Jurisdiction – The CFPB does not have direct supervisory authority over institutions that fall below $10 billion in assets.

- CFPB Small Creditor Definition – Residential mortgage loans are granted Qualified Mortgage status if the bank has less than $2 billion in total assets.

- CFPB Balloon Loan Qualified Mortgages – Residential mortgage loans are granted Qualified Mortgage status if the bank has less than $2 billion in total assets and the institution originates 50 percent or less of its mortgages in rural or underserved areas.

- CFPB Escrow Exemptions – Banks are exempt from escrow requirements if the bank has less than $2 billion in total assets and the institution originates 50 percent or less of its mortgages in rural or underserved areas.

- Treatment of Trust Preferred Securities (TruPS) Under the Collins Amendment – Grandfathers TruPS issued before May 19, 2010 into regulatory capital for BHCs with less than $15 billion in assets.

- Home Mortgage Disclosure Act (HMDA) Reporting Criteria – Banks with less than $44 million in assets are exempt from reporting HMDA data as required under Regulation C.

- Interchange Transaction Fees -- debit card issuers with less than $10 billion in assets are not subject to Dodd-Frank cap on interchange transaction fees.

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APPENDIX B

Below are just a few cases in which state regulators have proven to be particularly adept at developing and implementing flexible practices to better serve our smaller institutions and our local constituents. Some of these examples are broad, historic initiatives that have significantly shaped the trajectory of U.S. banking regulation and supervision, such as the joint and coordinated bank examination framework. Other examples provide local snapshots highlighting the flexibility that individual states exercise on a regular basis.

Texas Financial Education Initiatives

The Texas Department of Banking became actively involved in financial education in 2006. Over the years, it has developed tools and helpful material to encourage bankers to get involved in financial literacy. One of the Department's initiatives was to encourage state-chartered banks to start in-school banking programs. By establishing a rule in 2008, similar to federal regulation, a Texas bank is permitted to operate a financial facility in a school without it being deemed a branch. The initiative is named the Center of Monetary Education for Texans, or COMET.

The Department's Financial Education Coordinator (FEC) is active in community outreach activities and participates in a variety of speaking engagements and training events in English and Spanish. One outreach tool utilized to encourage financial education in the community is quarterly webinars. The Department's FEC organizes webinars on a variety of topics, offering resources and guidance to audiences of bankers and professional educators from around the country.

Joint Examinations of Multi-Charter Holding Companies

Joint bank examinations trace their roots back more than two decades, when due to interstate branching restrictions, bank holding companies would often own independently chartered banks in different states. To improve regulatory efficiency, state banking agencies began conducting joint examinations of multi-charter holding companies with other state regulators.

Before the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 (Riegle-Neal), states like Iowa and Indiana were already coordinating with other state banking regulators to conduct joint state examinations for multi-charter holding companies. This approach eliminated regulatory duplication, reduced the regulatory burden on the individual banks and the holding company, and helped the regulators develop a holistic view of the entire holding company. Once Riegle-Neal was passed, states built upon their existing practices in order to coordinate with federal supervisors, crafting examination plans across state and agency lines. In 1996, the states formalized cooperative and coordination agreements, the Nationwide Cooperative Agreement[25] and Nationwide State-Federal Supervisory Agreement,[26] to facilitate

[25] Nationwide Cooperative Agreement (Revised 1997). Available at: http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/nationwide_coop_agrmnt.pdf

the supervision of multi-state banks and to define the nature of state-federal supervision. These agreements set up a model centered on the examination team of the holding company or lead institution and, while close to 20 years old, still form the basis for state-federal supervisory interaction. These agreements foster effective coordination and communication among regulators and have led to a supervisory model that reduces burden and enhances responsiveness to local needs and interests in an interstate banking and branching environment.

This process ultimately leads to a more consistent examination experience for these community institutions. Rather than the holding company having to handle numerous examinations throughout the year, regulators conduct coordinated examinations of all the holding company's institutions at the same time, satisfying state and federal supervisory requirements in a streamlined manner.

This is just one of many illustrations of how state regulatory agencies have shown great flexibility and willingness to reduce burden for their state-chartered institutions, all while maintaining the same level of effective oversight.

Central Point of Contact

Many state banking departments follow the practice of assigning a single individual as a central point of contact to specific institutions to conduct ongoing off-site surveillance and monitoring. The off-site portion of this process promotes efficient and effective state supervision, allowing examiners to carry out their work away from the bank, freeing up bankers' time and office space. At the same time, central points of contact also provide banks with a single person to turn to when they have supervisory questions and issues, ensuring a more direct, faster response to their needs.

CSBS Loan Scoping Job Aid

In addition to coordination with the industry to make supervision more efficient, state regulators are increasingly turning to technology to enhance and streamline supervision. In 2012, CSBS published a Loan Scoping Job Aid (job aid) for examiners that encourages state regulators to consider institution-specific criteria that may lead to a smaller, yet more effective, loan review methodology.[27] Loan review is the cornerstone of safety and soundness examinations, providing examiners the best avenue for determining a bank's health. The CSBS job aid provides methods for examiners to improve their loan scope by reviewing a different sample of loans than would otherwise be the case. This more thoughtful, risk-focused, yet surgical approach will help regulators identify new risks and provide community banks with more meaningful and useful examination results.

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[26] Nationwide State/Federal Supervisory Agreement (1996). Available at: http://www.csbs.org/regulatory/Cooperative-Agreements/Documents/nationwide_state_fed_supervisory_agrmnt.pdf

[27] Available at: http://www.csbs.org/regulatory/resources/Pages/JobAids.aspx

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Appendix C

Part and parcel of promoting safety and soundness for community banks is ensuring that we have the necessary understanding of the health, opportunities, and challenges facing community banks in the 21st century. As such, state regulators are regularly engaged in several complementary initiatives designed to better inform their understanding of community banks.

I would like to share some of the findings we have gathered through our community bank research conferences from academic research, the national survey of community banks, and our town hall meetings with community banks. I would also like to illustrate how our holistic approach to research can lead to better policy outcomes for community banks.

Academic Research on Community Banks

While there have only been two community bank research conferences thus far, we have already benefitted from valuable data and research findings that show the importance of community banks and the centrality of their relationship lending model. For example, we now know that when a bank fails, the end result is measurable economic underperformance.[28] Research also shows that the closer a business customer is to a community bank, the more likely the start-up borrower is to receive a loan.[29] Community banks also have a key advantage through "social capital," which supports well-informed financial transactions. This so called "social capital" is the basis for relationship lending and exists because community bankers live and work in the same communities that their banks do business. The success of the community bank is tied directly to the success of consumers and businesses in those communities. This is especially true in rural areas, where the community bank relationship lending model results in lower default rates on U.S. Small Business Administration loans than their urban counterparts.[30]

We are also discovering the extent to which governmental policies can impact community banks. For example, research shows that more than 80 percent of community banks have reported a greater than 5 percent increase in compliance costs since the passage of the Dodd-Frank Act.[31] Research has also informed us that the federal banking agencies' appeals processes are seldom used, inconsistent across agencies, and at times dysfunctional.[32] We can also see that macro-prudential regulation can have a meaningful impact on bank behavior, but

[28] Kandrac, J. "Bank Failure, Relationship Lending, and Local Economic Performance." Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2013/Kandrac_BankFailure_CBRC2013.pdf.
[29] Lee, Y., and S. Williams. "Do Community Banks Play a Role in New Firms' Access to Credit?" Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2013/Lee_Williams.pdf.
[30] DeYoung, R., et. al. "Small Business Lending and Social Capital: Are Rural Relationship Different?" Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2013/DGNS_2012_SBA_lending.pdf.
[31] Peirce, H., I. Robinson, and T. Stratmann. "How Are Small Banks Faring Under Dodd-Frank?" Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2014/SESSION3_Peirce_Robinson_Stratmann.pdf
[32] Hill, J. "When Bank Examiners Get It Wrong: Financial Institution Appeals of Material Supervisory Determinations." Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2014/SESSION2_AndersonHill.pdf

that it may also cause unintended consequences.[33] We hope that findings like these will inform policymakers' work designing a right-sized policy framework for community banks.

National Survey of Community Banks

The community banker survey we conduct as part of the research conference provides us with crucial information straight from the industry.[34] For example, bankers have been very vocal about the compliance burdens associated with the new Ability-to-Repay and Qualified Mortgage rules. Our research finds that community banks continue to see residential mortgage lending as a meaningful business opportunity, but have a mixed view of making non-QM loans, with 26 percent of respondents indicating that they would not originate non-QM loans and an additional 33 percent only originating non-QM on an exception basis. Assessing the new ATR and QM mortgage standards against existing loans, 67 percent of bankers identified a low level of non-conformance, suggesting the two rules generally align with existing bank practices.

Community banks have long voiced concerns about increasing regulatory compliance costs, but these costs have been difficult to quantify historically. To encourage additional data and research in this area, the national survey sought to identify how increased compliance costs are realized in community banks' operations. Survey data show that rising compliance costs primarily take the shape of spending additional time on compliance, hiring additional compliance personnel, and increasing reliance on third-party vendors.

The survey also showed us that less than a quarter of respondents plan to add new products and services in the next three years. We must take this as an important red flag. Any industry that is not in a position to innovate while the world around it is innovating has questionable long-term viability.

Community Banker Town Hall Meetings

Community bankers in the town hall meetings were quite clear: the ATR and QM mortgage rules have required banks to make significant operational changes in order to comply. These changes have increased the cost of origination, the cost to the consumer, and have reduced the number of loans a bank can make.

Bankers also indicated that compliance burdens and security concerns are significant headwinds to launching new products and innovation. Similarly, bankers expressed that new regulations have changed how they approach serving their customers, shifting their mentality away from creating flexible products for customers and towards what regulations allow them to do.

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[33] Bassett, W. and W. Marsh. "Assessing Targeted Macroprudential Financial Regulation: The Case of the 2006 Commercial Real Estate Guidance for Banks." Available at: https://www.stlouisfed.org/~/media/Files/PDFs/Banking/CBRC-2014/SESSION2_Bassett_Marsh.pdf

[34] The survey data is available at: https://www.stlouisfed.org/bank-supervision/2014-community-banking-conference/2014-survey-data.

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Holistic Research Leads to Better Policy Outcomes

Looking at these research conference findings together should cause policymakers to ask serious questions about our approach to regulating community banks. In the context of the ATR and QM mortgage rules, if new requirements are generally consistent with most community banks' practices, should implementation of these rules result in increased costs and a reduction in credit availability? When we think about community banking products, should regulatory compliance burdens inhibit community banks from offering innovative products to their customers? These are not outcomes any policymaker should want, and we must be responsive to what the industry and empirical research is telling us.

More importantly, this information can lead policymakers to better policy outcomes, if we let it. We are seeing more clearly the role and value that community banks play in our economies. This should inform and inspire us to not establish broad asset thresholds out of political pressure, but to craft a meaningful regulatory framework for a community banking business model that provides real value and presents limited risk to the financial system.

The 2015 Community Banking in the 21st Century Research Conference will be held this fall at the Federal Reserve Bank of St. Louis. We are pleased that Chair Yellen is planning on attending and addressing the conference. We have already issued a call for research papers and are planning our national survey and town hall events. State regulators have been encouraged by the overwhelming demand for this conference. We have been pleased at the growing response to the call for papers over the past two years and expect the response and interest in the conference to continue to grow.

STATEMENT OF

DOREEN R. EBERLEY
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DIVISION OF RISK MANAGEMENT SUPERVISION
THE FEDERAL DEPOSIT INSURANCE CORPORATION

on

EXAMINING REGULATORY BURDENS – REGULATOR PERSPECTIVE

before the

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

COMMITTEE ON HOUSING AND FINANCIAL SERVICES
U.S. HOUSE OF REPRESENATIVES

April 23, 2015
HVC-210 CAPITOL VISITOR CENTER

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on regulatory relief for community banks. As the primary federal regulator for the majority of community banks, the FDIC has a particular interest in understanding the challenges and opportunities they face.

My testimony will highlight the profile and key performance information for community banks. I then will discuss the ongoing interagency review to identify outdated, unnecessary, or unduly burdensome regulations. Next, I will describe how the FDIC continually strives to implement both regulations and our supervision program in a way that reflects differences in risk profile among industry participants, while achieving our supervisory goals of a safe and sound banking system. Finally, I will touch on our continued work under our Community Bank Initiative to respond to requests we have received from community banks for technical assistance.

Community Bank Profile

Community banks provide traditional, relationship-based banking services to their communities, including many small towns and rural areas that would otherwise not have access to any physical banking services. Community banks (as defined in FDIC research[1]) make up 93 percent of all banks in the U.S. – a higher percentage than at any

[1] FDIC-insured commercial banks and savings institutions are defined to be community banks if they meet the criteria that were developed for the FDIC's Community Banking Study published in December 2012: http://fdic.gov/regulations/resources/cbi/report/cbi-full.pdf. These criteria go beyond asset size alone to account for each institution's lending and deposit-gathering activities, as well as the limited geographic scope of operations that is characteristic of community banks.

time going back to at least 1984. While community banks hold just 13 percent of all banking assets, they account for about 45 percent of all of the small loans to businesses and farms made by insured institutions. Although 448 community banks failed during the recent financial crisis, thousands of community banks -- the vast majority -- did not. Institutions that stuck to their core expertise weathered the crisis. The highest rates of failure were observed among non-community banks and among community banks that departed from the traditional model and tried to grow rapidly with risky assets often funded by volatile non-core and often non-local brokered deposits.

According to the latest available data, as of December 31, 2014, the overall financial condition of both community banks and the industry as a whole has continued to improve. Community banks earned $4.8 billion during the fourth quarter, an increase of 28 percent from a year ago. Higher net interest income, increased noninterest income, and lower provision expenses were the primary drivers of stronger earnings at community banks. Net interest income for community banks grew 6.4 percent over the year-ago quarter, outpacing the industry growth of 1.0 percent. Meanwhile, community bank loan balances rose by 8.6 percent over the past year compared to 5.3 percent for the industry. Community banks reported growth in all major loan categories, including residential mortgages and loans to small businesses, and asset quality showed continued improvement with the volume of noncurrent loans 19.1 percent lower at the end of the fourth quarter from a year earlier.

While the financial performance of community banks has continued to improve since the crisis, especially as compared to the industry as a whole, the FDIC is keenly aware of the impact that its regulatory requirements can have on smaller institutions, which operate with fewer staff and other resources than their larger counterparts. As the primary federal regulator for the majority of community banks, the FDIC pays particular attention to the impact its regulations may have on smaller and rural institutions that serve areas that otherwise would not have access to banking services, and the input community bankers provide regarding such impact.

EGRPRA Review and Progress to Date

The FDIC and other regulators are actively seeking input from the industry and the public on ways to reduce regulatory burden. The *Economic Growth and Regulatory Paperwork Reduction Act of 1996*[2] (EGRPRA) requires the Federal Financial Institutions Examination Council (FFIEC),[3] the FDIC, the Federal Reserve Board (FRB), and the Office of the Comptroller of the Currency (OCC) to review our regulations at least once every ten years to identify any regulations that are outdated, or otherwise unnecessary. EGRPRA also requires the agencies to eliminate unnecessary regulations to the extent such action is appropriate. The second decennial EGRPRA review is in process with a required report due to Congress in 2016. The FDIC has developed a comprehensive plan

[2] Public Law 104-208 (1996), codified at 12 U.S.C. § 3311

[3] The FFIEC is composed of the Board of Governors of the Federal Reserve System (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Consumer Financial Protection Bureau (CFPB) and the State Liaison Committee (SLC), which is made up of representatives from the Conference of State Bank Supervisors (CSBS), the American Council of State Savings Supervisors (ACSSS), and the National Association of State Credit Union Supervisors (NASCUS).

for conducting its EGRPRA review that includes coordination with the other Federal banking agencies.[4]

On June 4, 2014, the Federal banking agencies jointly published in the *Federal Register* the first of a series of requests for public comment on regulations. The first request for comment covered applications and reporting, powers and activities, and international operations. The comment period for this request closed on September 2, 2014, and 40 comments were received and are being reviewed. On February 12, 2015, the agencies published the second request for public comment, focusing on regulations covering banking operations, capital, and the Community Reinvestment Act. The comment period for that set of regulations will close on May 14, 2015.

To date, the agencies have held two regional outreach meetings – one in Los Angeles and one in Dallas -- to receive direct input from the public as part of the EGRPRA review process. Presenters thus far have included bankers, community groups, and consumer groups, and the events have been attended by agency principals and senior agency staff. Additional meetings are scheduled currently for Boston on May 4, 2015; Chicago on October 19, 2015; and Washington, DC on December 2, 2015. The agencies also plan to hold an outreach meeting in Kansas City on August 4, 2015, that will be focused on rural banks. To increase public awareness of the EGRPRA process, the meetings can be viewed via live webcast, and transcripts and video recordings also are being made publicly available

[4] http://www.fdic.gov/EGRPRA/

I also would note that the agencies intend to solicit comment on all regulations that have been issued in final form up to the publication date of the last EGRPRA notice, which is expected by year end. The agencies will accept comment on any rules at the remaining public outreach meetings. The agencies will consider all comments received and will take action as warranted on suggested changes or provide recommendations to Congress if statutory changes are required.

In response to what we heard in the first rounds of comments, the FDIC already has acted on regulatory relief suggestions where we could achieve rapid change. We communicated these changes to bankers through two Financial Institution Letters (FILs), which are our primary communication tool for policy and guidance.

The first FIL released questions and answers (Q&As) about the deposit insurance application process to aid applicants in developing proposals for federal deposit insurance and to enhance the transparency of the application process.[5] Some EGRPRA commenters – and others – indicated that there was some confusion about the FDIC's existing policies and suggested that a clarification would be helpful. The Q&As address four distinct topics: the purpose and benefits of pre-filing meetings, processing timelines, initial capitalization requirements, and business plan requirements.

[5] https://www.fdic.gov/news/news/financial/2014/fil14056.html#continuation

The second FIL addressed new procedures that eliminate or reduce the need for institutions to file applications to conduct permissible activities through certain bank subsidiaries organized as limited liability companies, or LLCs, subject to some limited documentation standards. The prior procedures dated back to the time when the LLC structure was first permitted for bank subsidiaries. In the past ten years, the FDIC processed more than 2,200 applications relating to bank activities; the vast majority of these applications involved subsidiaries organized as LLCs. Commenters remarked, and we agreed, that an LLC is no longer a novel structure and does not create particular safety and soundness concerns. We are confident that the new procedures will result in a more streamlined process for the institutions we supervise – especially our community institutions – without compromising the FDIC's safety and soundness standards.

Several areas of focus are emerging through the EGRPRA process that could address community banker concerns. One such area involves the consideration of whether laws and regulations based on long-standing thresholds should be changed – for example, dollar thresholds requiring an appraisal or a currency transaction report. Along these same lines, commenters have expressed an interest in decreasing the frequency of examinations set forth in statute, increasing the size of the institutions eligible for longer examination intervals, or both. Commenters also have asked that we ensure that supervisory expectations intended for large banks are not applied to community banks and that we have open and regular lines of communication with community bankers. We look forward to continuing to receive comments during the EGRPRA process and our outreach sessions, and we intend to carefully consider comments received. It is our

intention to continue looking for ways to reduce or eliminate outdated or unnecessary requirements as we move forward with this review, rather than wait until the end of the EGRPRA process.

Tailored Supervisory Approach for Community Banks

The FDIC has long tailored its supervisory approach to the size, complexity, and risk profile of each institution. This approach is embedded throughout our supervisory program, which includes issuing rulemakings and guidance, and maintaining a highly trained and professional examiner workforce to conduct periodic, on-site examinations and ongoing monitoring.

Rulemakings and Guidance

The FDIC considers the size, complexity, and risk profile of institutions during the rulemaking and supervisory guidance development processes and on an ongoing basis through feedback we receive from community bankers and other stakeholders. Where possible, we scale our regulations and policies according to these factors. The FDIC's policy statement on the development and review of regulations includes a goal of minimizing regulatory burdens on the public and the banking industry. Additionally, all of our FILs have a prominent community bank applicability statement so community bankers can immediately determine whether the FIL is relevant to them.

A number of recent FDIC rulemakings implemented provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) designed to benefit community institutions. For example, the assessment base for deposit insurance

was changed from domestic deposits to average total assets minus average tangible equity, which shifted more of the deposit insurance assessment burden from smaller to larger institutions. As a result, aggregate premiums paid by institutions with less than $10 billion in assets declined by approximately one-third in the second quarter of 2011, primarily due to the assessment base change. Under the Dodd-Frank Act, the deposit insurance coverage limit was permanently increased to $250,000, which particularly benefits small businesses and other depositors of community institutions. The Dodd-Frank Act also increased the minimum reserve ratio for the Deposit Insurance Fund (DIF) from 1.15 percent to 1.35 percent, with the increase in the minimum target to be funded entirely by larger banks.

In addition to issuing rules to implement the Dodd-Frank Act provisions that benefit community banks, the FDIC also has taken into account the unique characteristics of community banks in its rulemaking to implement other important reforms to the financial system. The FDIC recognizes that a number of the more complex requirements of the capital rules are not necessary or suitable for community banks. Therefore, many aspects of the revised capital rules do not apply to community banks. For example, the new capital rules introduce a number of provisions aimed only at large, internationally active banks. These provisions include the supplementary leverage ratio, the countercyclical capital buffer, and capital requirements for credit valuation adjustments and operational risk, to name a few. In addition, the revised capital rules contain large sections that do not apply to community banks. Most notably, the advanced approaches

framework only applies to internationally active banks and the market risk rule only applies to banks with material trading operations.

The FDIC also addressed concerns about the application of the conservation buffer to S corporation institutions. In July 2014, we issued a FIL to FDIC-supervised institutions describing how we would treat certain requests from S corporation institutions under the new capital rules.[6] Many community banks are S corporation banks, and we issued this guidance because of feedback we heard from concerned S corporation banks and their shareholders. In the FIL, we informed FDIC-supervised banks that, barring any significant safety and soundness issues, we would generally approve requests from well-rated banks to pay dividends to their shareholders to cover taxes on their pass-through share of bank earnings when those dividends are otherwise not permitted under the new capital rules.

Examination Program

Every FDIC examiner is initially trained as a community bank examiner through a rigorous four-year program that teaches examination concepts, policies, and procedures. As a result, on the way to becoming commissioned examiners, they gain a thorough understanding of community banks. These examiners are knowledgeable and experienced in local issues of importance to community bankers and serve as a first-line resource to bankers regarding supervisory expectations.

[6] https://www.fdic.gov/news/news/financial/2014/fil14040.html

Our examiners conduct bank examinations using a risk-focused examination program, which tailors the supervisory approach to the size, complexity, and risk profile of each institution. Risk-focused examinations are based on core principles of safety and soundness, including risk identification and mitigation. Institutions with lower risk profiles, such as most community banks, are subject to less supervisory attention than those with elevated risk profiles. For example, well-managed banks engaged in traditional, non-complex activities receive periodic safety and soundness and consumer protection examinations that are carried out over a few weeks, while the very largest FDIC-supervised institutions are subject to continuous safety and soundness supervision and ongoing examination carried out through targeted reviews during the course of an examination cycle.

Our examination cycle is also tailored to the size and risk posed by a bank. The Federal Deposit Insurance Act requires regular safety and soundness examinations of state non-member banks at least once during each 12-month period. However, examination intervals can be extended to 18 months for well-run and well-rated institutions with total assets of less than $500 million. Most FDIC-supervised institutions have total assets less than $500 million. This longer cycle permits the FDIC to focus its resources on those segments of the industry that present the most immediate supervisory concern, while at the same time reducing the regulatory burden on smaller, well-run institutions that do not pose an equivalent level of supervisory concern.

FDIC policy guides consumer protection examination schedules, which also vary based on the institution's size, prior examination rating, and risk profile. Community Reinvestment Act (CRA) examination schedules conform to the requirements of the Gramm-Leach-Bliley Act, which established the CRA examination cycle for most small institutions. The FDIC also uses different CRA examination procedures based on the asset size of institutions. Those meeting the small and intermediate small asset-size threshold are not subject to the reporting requirements applicable to large banks and savings associations.

The FDIC uses off-site monitoring programs to supplement and guide the onsite examination process. Off-site monitoring allows the FDIC to expand the examination cycle for certain lower-risk institutions. Off-site monitoring programs also can provide an early indication that an institution's risk profile may be changing. The FDIC has developed a number of off-site monitoring tools using key data from banks' quarterly Reports of Condition and Income (Call Reports) to identify institutions that are experiencing rapid loan growth or reporting unusual levels or trends in problem loans, investment activities, funding strategies, earnings structure, or capital levels that merit further review.

Community Banking Initiative and Technical Assistance

FDIC Community Banking Study

Since late 2011, the FDIC has been engaged in a data-driven effort to identify and explore issues and questions about community banks. We presented our initial findings

in a comprehensive FDIC Community Banking Study, published in December 2012. Our subsequent research has studied community bank consolidation, long-term developments in branch banking, the effects of rural depopulation on community banks, and the efforts of minority-owned and operated depository institutions to serve their communities. The FDIC's community bank research agenda remains active, and in 2015, we will be studying the challenges faced by small, closely held banks, such as raising external capital and ensuring management succession.

New Community Bank Quarterly Banking Profile

Last year, the FDIC introduced a community bank section in the FDIC's Quarterly Banking Profile. The QBP, as it is commonly known, is a long-standing tool that the industry, regulators, policymakers, investors, analysts, consumers, and other stakeholders use as a report card on the banking industry. We launched the Community Bank QBP to ensure that community bank performance was not obscured in the overall industry picture because of the small size of these institutions. The most recent analysis of that data was presented earlier in this testimony.

Community Bank Outreach and Technical Assistance

In 2009, the FDIC established its *Advisory Committee on Community Banking* to provide advice and guidance on a broad range of policy issues affecting small community banks and the local communities they serve. In February 2012, the FDIC sponsored a national conference to examine the unique role of community banks in our nation's economy. Later in 2012, we held roundtable discussions in each of the FDIC's regions

that focused on the financial and operational challenges and opportunities facing community banks, and the regulatory interaction process. Additional roundtable discussions were held in each region in 2013 and 2014.

In 2013, based on community banker feedback, the FDIC restructured our pre-examination process to better tailor pre-examination activities to the unique risk profile of the individual institution. As part of this process, we developed and implemented an electronic pre-examination planning tool to ensure consistency nationwide. This tool also helps minimize burden by ensuring that only those items that are necessary for the examination process are requested from each institution.

We also instituted a number of outreach and technical assistance efforts, including more than 20 training videos on complex topics of interest to community bankers. For example, we issued six videos designed to provide new bank directors with information to prepare them for their fiduciary role in overseeing the bank, and a virtual version of the FDIC's Directors' College Program. We also have issued a series of videos, primarily targeted to bank officers and employees, providing more in-depth coverage of important supervisory topics with a focus on bank management's responsibilities.[7]

To assist bankers in complying with the revised capital rules, the FDIC conducted outreach and technical assistance designed specifically for community banks. In addition to the publication of a community bank guide and an informational video on the revised

[7] *Technical Assistance Video Program*: https://www.fdic.gov/regulations/resources/director/video.html.

capital rules, FDIC staff conducted informational sessions with bankers in each of the FDIC's six supervisory regions to discuss the revised capital rules most applicable to community banks.

We also hosted banker call-ins on topics such as proposed new accounting rules, new mortgage rules, and Call Report changes. The FDIC offers a series of Deposit Insurance Coverage seminars for banking officers and employees.[8] These free seminars, which are offered nationwide, particularly benefit smaller institutions, which have limited training resources.

In June 2014, the FDIC mailed an Information Packet[9] to the chief executive officers (CEOs) of FDIC-supervised community banks that contained resources and products developed as part of the FDIC's Community Banking Initiative, as well as documents describing our examination processes. In addition to an introductory letter to CEOs, the packet contained brochures highlighting the content of key resources, such as the FDIC's Ombudsman and Supervisory Appeals Review Committee; programs, including the technical assistance video series; and a copy of the FDIC's Cyber Challenge simulation exercise. Cyber Challenge was designed to encourage community banks to discuss operational risk issues and the potential impact of information technology disruptions. The exercise contained four videos that depict various operational disruptions and materials to facilitate discussion about how the bank would

[8] *Deposit Insurance Coverage: Free Nationwide Seminars for Bank Officers and Employees* (FIL-17-2014), dated April 18, 2014.
[9] See http://www.fdic.gov/regulations/resources/cbi/infopackage.html

respond. Lists of reference materials where banks could obtain additional information were also included. All of these resources can be found on the *Directors' Resource Center*, available through the FDIC's website.[10]

At the local level, we have enhanced communication efforts by having our community bank examiners contact supervised institutions between examinations to discuss and clarify supervisory and regulatory changes and the overall risk profile of the institutions.

Going forward, the FDIC intends to continue to be a resource for community banks regarding developing industry issues. One recent example involves Call Reports. We have received comments from institutions and others about the cost and burden of preparing Call Reports. We also have heard comments about the benefits of Call Reports, including their aforementioned use in extending examination cycles and the transparency they bring to the industry for investors, bankers, consumers, analysts, and other stakeholders. Working through the FFIEC, we have talked to the industry about ways to improve Call Reports and the reporting process, and we will pursue several actions in the near term. For example, we plan to propose certain burden-reducing changes this year and implement a more robust process for bank agency users to justify retaining or adding items to the Call Report.

[10] See https://www.fdic.gov/regulations/resources/director/.

Conclusion

Preserving the long-term health and vibrancy of community banks, and their ability to serve their local communities means preserving the core strengths of community banks: strong capital, strong risk management, and fair and appropriate dealings with their customers. Most community banks know how to manage the risks in their loan portfolios and have strong capital positions. And of course, community banks have a strong interest in retaining customers by treating them fairly. Serving the credit needs of their local communities, while managing the attendant credit risks, truly is the core expertise of many community banks.

Community banks with sound risk management practices and strong capital have been able to weather crises and remain strong. Institutions that did not survive crises were those with weaker or more aggressive risk management approaches, including imprudent loan underwriting and rapid growth often financed by wholesale funds or brokered deposits.

The FDIC will continue to look for ways to improve our supervisory processes and reduce regulatory burden on the industry. Our goal is to achieve the fundamental objectives of safety and soundness and consumer protection in ways that do not involve needless complexity or expense

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April 23, 2015

Congressional Testimony

Larry Fazio
Director, Office of Examination and Insurance
National Credit Union Administration

House Financial Institutions and Consumer Credit Subcommittee

Hearing on Examining Regulatory Burdens – Regulator Perspectives

NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of more than 99 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At MyCreditUnion.gov and Pocket Cents, NCUA also educates the public on consumer protection and financial literacy issues.

Congressional Testimony

Chairman Neugebauer, Ranking Member Clay, and Members of the Committee, the National Credit Union Administration appreciates the invitation to testify about regulatory relief. I am Larry Fazio, Director of NCUA's Office of Examination and Insurance.

Today, more than three-quarters of credit unions have less than $100 million in assets, and the median asset size of a credit union is $24.5 million.[1] As smaller depository institutions, credit unions generally have limited resources available to respond to marketplace, technological, legislative, and regulatory changes. NCUA, therefore, recognizes and acts continually to fine-tune our rules and examinations to remove any unnecessary burden on credit unions.

NCUA scales our regulatory and supervisory expectations to credit union size and complexity. NCUA also seeks to provide broader regulatory relief when it is sensible and within the agency's authority to do so. Over the past three years, we have taken many actions to cut red tape and provide lasting benefits to credit unions, including relaxing eight regulations and streamlining four processes. This year, we also have already proposed eliminating our fixed-assets rule and modifying the threshold for defining a small credit union to provide special consideration for regulatory relief in future rulemakings. And next week, the NCUA Board will consider a final rule to make it easier for federal credit unions to add new groups to their fields of membership.

Where regulation is needed to protect the safety and soundness of credit unions and the National Credit Union Share Insurance Fund, NCUA uses a variety of strategies to ensure our rules are effectively targeted.[2] These strategies include fully exempting small credit unions from certain rules, using graduated requirements as size and complexity increase for others, and incorporating practical compliance approaches in agency guidance. Thus, we work to balance maintaining prudential standards with minimizing regulatory burden.

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[1] The term "credit union" is used throughout this testimony to refer to federally insured credit unions. NCUA does not oversee approximately 129 state-chartered, privately insured credit unions. As of December 31, 2014, federally insured credit unions represented 98 percent of all credit unions in the United States.

As a policy matter, in 2007 NCUA issued a report to Congress concluding that the federal government should be the sole provider of primary deposit insurance. Federal deposit insurance has played an important role in maintaining confidence in the financial system and the stability of our economy, and the lessons learned from failures of private deposit insurance schemes should not be forgotten. See http://www.ncua.gov/Legal/Documents/DepositInsuranceStudyReporttoCongress-Ver6-4.pdf for more details.

[2] Congress established the National Credit Union Share Insurance Fund in 1970 as part of the Federal Credit Union Act (P.L. 91-468) and amended the Share Insurance Fund's operations in 1984 (P.L. 98-369). The fund operates as a revolving fund in the U.S. Treasury under the administration of the NCUA Board for the purpose of insuring member share deposits in all federal credit unions and in qualifying state-chartered credit unions that request federal insurance. Funded by federally insured credit unions, the Share Insurance Fund is backed by the full faith and credit of the United States.

My testimony today will examine the state of the credit union system and the factors contributing to credit union consolidation. I will also outline some of NCUA's ongoing efforts to support small credit unions. Additionally, I will review elements of NCUA's current rulemaking process, including recent and prospective efforts to tailor regulation and supervision based on the size and complexity of credit unions, as well as NCUA's voluntary participation in the current interagency review process under the Economic Growth and Regulatory Paperwork Reduction Act. I will further discuss NCUA's efforts to reduce examination burdens. Finally, I will highlight several legislative recommendations to provide regulatory relief for credit unions.

Credit Union System Trends

The credit union system continues to experience steady growth in terms of members and assets. At the end of 2014, there were 6,273 credit unions serving nearly 99.3 million members. All but 227 of these credit unions had less than $1 billion in assets, the asset threshold used to define a community financial institution.

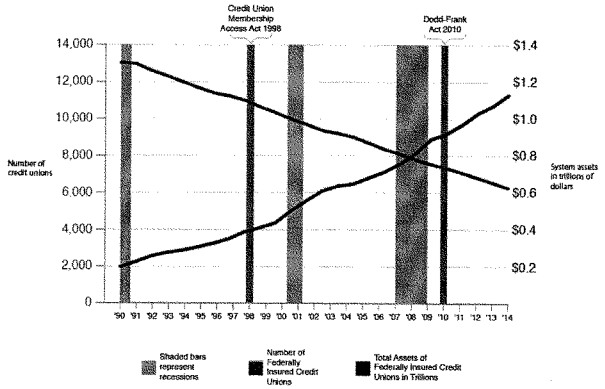
Nevertheless, long-time consolidation trends within the credit union system have continued. As the graph on the next page shows, the pace of credit union consolidation has been steady over more than two decades and across a variety of economic cycles, including the recession of the early 1990s, the bust of the technology boom in the early 2000s, and the recent Great Recession. The trend also has remained relatively constant after the passage of landmark laws like the Credit Union Membership Access Act of 1998 and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The long-term path of credit union consolidation is very similar to the consolidation trends occurring among banks and thrifts.

Despite the steady decline in the number of credit unions in the last 20 years, the assets within the credit union system have risen substantially over the same timeframe. Today, as shown in the same graph on the next page, credit union system assets exceed $1.1 trillion, a more than five-fold increase over 1990. Credit union membership also has nearly doubled over the same time period.

Credit union consolidation is primarily occurring among small institutions. During the past five years, 1,211 consumer credit unions have exited the system as a result of a merger. More than 90 percent of these former credit unions had assets of $50 million or less at the time of the merger, and another 6 percent held assets between $50 million and $100 million.

The existence of small credit unions is being challenged by the convergence of several circumstances. For example, the financial services marketplace is rapidly evolving, and it is difficult to keep pace with marketplace and regulatory developments. Additionally, small credit unions face challenges in attracting and retaining talent.

Federally Insured Credit Unions



Another critical factor contributing to the decline in the number of small credit unions is that many generally cannot take advantage of economies of scale given their size. This results in relatively high operating costs and weak earnings. Lack of size and scope also makes it difficult for these credit unions to adopt the technological and product innovations demanded by consumers.

Today, roughly 50 percent of credit unions with less than $50 million in assets provide all four of these services: checking accounts, real estate loans, ATM and debit cards, and home banking services (including mobile banking). In contrast, almost all credit unions with assets of greater than $50 million provide each of these services. These differences have persisted over the past ten years, underscoring the competitive challenges small credit unions confront.

Other factors contributing to the decline of credit unions include the lack of adequate succession planning to compensate for the retirements of key employees and a single-sponsor credit union that loses its sponsor. Bad management decisions, insufficient internal controls, and employee fraud also have played a role in the system's consolidation. In all, employee fraud was a contributing factor to $337 million in losses for the Share Insurance Fund between 2010 and 2014 at liquidated credit unions.

Support for Small Credit Unions

NCUA does what it can to help viable small credit unions to survive and thrive.

Through our Office of Small Credit Union Initiatives, we offer training, information on successful growth and service strategies, and support opportunities for small institutions to partner and collaborate. The webinars and videos produced by the office have been extremely popular among small credit unions. Topics covered by these videos include the responsibilities of supervisory review committees and fraud prevention. In 2014, NCUA trained 45,487 individuals, an increase of 76 percent over the previous year.

Additionally, the Office of Small Credit Union Initiatives provides affirmative assistance to small credit unions through free consulting, such as the net worth restoration plan assistance required by the Federal Credit Union Act.[3] The office also awards grants and offers reduced-rate loans to low-income credit unions—many of which are small credit unions—through the Community Development Revolving Loan Fund.[4]

Finally, NCUA seeks, where possible, to keep regulatory burdens as low as possible, exempting many credit unions from certain rules and providing them with simplified compliance approaches for others. In recent years, NCUA also has streamlined exams for smaller credit unions. Each of these topics is discussed in greater detail below.

Regulatory Flexibility Act Threshold and Results

Under the Regulatory Flexibility Act, NCUA must publish an analysis in the *Federal Register* and give special consideration to the regulatory burden and alternatives for small credit unions whenever a proposed or final rule would impose a significant economic impact on a substantial number of small credit unions.[5]

In recognition of the operational and financial challenges faced by smaller credit unions, the NCUA Board has recently proposed and implemented substantial increases in the asset threshold used to define "small" for the purposes of the Regulatory Flexibility Act. In January 2013, the Board increased the asset threshold to $50 million, a five-fold increase from the previous $10 million. The change nearly doubled the number of credit unions

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[3] 12 U.S.C. 1790d(l)(2).

[4] Created and funded by Congress, the Community Development Revolving Loan Fund enables low-income credit unions to provide financial services and stimulate economic activities in underserved communities, as well as reach members who have limited access to basic financial services. In 2014, NCUA awarded more than $1.5 million in grants to 276 low-income designated credit unions, of which 170 were first-time awardees. Demand for these funds has consistently and significantly exceeded available appropriations.

[5] The Regulatory Flexibility Act provides NCUA with the opportunity to define which credit unions fall under the law's coverage. 5 U.S.C. 601(4).

classified as small. Today, 4,050 institutions representing 65 percent of all credit unions are covered by the small credit union definition.

At the same time it revised the small credit union definition, the NCUA Board provided immediate regulatory relief by exempting credit unions under $50 million from several regulatory requirements. First, the Board increased from $10 million to $50 million the threshold defining which credit unions are complex, narrowing the category of credit unions that could be subject to risk-based net worth requirements and the associated prompt corrective action mandates. Second, the Board increased from $10 million to $50 million the threshold used to exempt credit unions from our interest rate risk rule.

In a coordinated policy change, the Board nearly doubled the number of credit unions eligible to apply for NCUA's Office of Small Credit Union Initiatives' individualized consulting services by increasing the eligibility threshold to $50 million. Subsequently, the NCUA Board extended relief at the same level in new rules requiring certain liquidity contingencies and creditor notices in voluntary liquidations.

In January 2013, the NCUA Board also committed the agency to revisit the Regulatory Flexibility Act threshold in 2015 and every three years thereafter.[6] The Board took this action to ensure the definition of a small credit union would keep pace with changes in the marketplace. Consequently, in February 2015, the Board approved a proposed rule and policy statement to double the threshold from $50 million to $100 million. This change would provide special consideration for regulatory relief in future rulemakings for an additional 734 credit unions.

Should the Board adopt a $100 million threshold in the final rule, 76 percent of all credit unions would be covered in future rulemakings for special consideration of regulatory relief.[7] Taking this action also would recognize the challenges encountered by credit unions below $100 million in assets. They have slower deposit growth rates, slower membership growth rates, higher operating costs, and lower returns on average assets than peer credit unions above the threshold.[8]

Regulatory Review Efforts

NCUA is ever mindful of the impact of our regulations on credit unions, especially smaller ones. We are proactive in our efforts to identify outdated, ineffective, or excessively burdensome regulations. We also continually review and take appropriate steps to eliminate or ease burdens, whenever possible, without compromising safety and soundness.

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[6] This triennial review of the small credit union definition under the Regulatory Flexibility Act is in addition to NCUA's rolling three-year review of all regulations.

[7] Credit unions with less than $100 million in assets hold 10 percent of the system's assets as of December 31, 2014.

[8] See Appendix I for a breakdown of credit union performance by asset class over time.

Rolling Regulatory Review

Since 1987, NCUA has followed a well-delineated and deliberate process to continually review its regulations and seek comment from stakeholders, such as credit unions and trade associations. Through this agency-initiated process, NCUA conducts a rolling review of one-third of its regulations each year—meaning that we review all of our regulations at least once every three years.

This long-standing regulatory review policy helps to ensure NCUA's regulations:

- Impose only the minimum required burdens on credit unions, their members, and the public.
- Are appropriate for the size of the credit unions regulated by NCUA.
- Are issued only after full public participation in the rulemaking process.
- Are clear and understandable.

This rolling review is fully transparent. NCUA publishes on our website a list of the applicable regulations up for review each year and invites public comment on any or all of the regulations.[9]

Economic Growth and Regulatory Paperwork Reduction Act

Additionally, NCUA is voluntarily participating in the ongoing interagency review process created by the Economic Growth and Regulatory Paperwork Reduction Act of 1996.[10] EGRPRA requires the Federal Financial Institutions Examination Council and its member federal banking agencies to review their regulations at least once every 10 years to identify any rules that might be outdated, unnecessary, or unduly burdensome. NCUA is not required to participate in this process, but the agency has voluntarily elected to do so once again.

Under the EGRPRA review, each agency is issuing several categories of rules for public comment at regular intervals over two years—with an eye toward streamlining, modernizing, or even repealing regulations when appropriate. The categories developed and used by NCUA are:

- Agency Programs,
- Applications and Reporting,

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[9] See http://www.ncua.gov/Legal/Regs/Pages/Regulations.aspx.
[10] 12 U.S.C. 3311.

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

In May 2014, the NCUA Board released for review 33 regulations in the Applications and Reporting and Powers and Activities categories. NCUA subsequently received five comments. In response to these comments, Board Chairman Debbie Matz established two internal working groups to consider possible changes in the areas of field of membership and secondary capital. The working groups are now reviewing stakeholders' suggestions from the first notice, as well as other ideas, and will make recommendations on potential regulatory and legislative changes in both areas before the end of the year.

Earlier this month, NCUA also moved ahead with streamlining the process by which low-income credit unions obtain secondary capital from investors.[11] These supervisory changes will expedite the approval of secondary capital requests by regional offices and make it possible for low-income credit unions with secondary capital to return portions of the loans that no longer count towards net worth. The changes also give investors greater clarity and confidence.

In the agency's second EGRPRA notice in December 2014, NCUA opened 17 rules for comment in three additional categories: Agency Programs, Capital, and Consumer Protection. Before the comment period closed in March, NCUA received eight comments from stakeholders.

As part of NCUA's voluntary participation in the latest EGRPRA review, NCUA will evaluate the burden on credit unions for those regulations within NCUA's control. The agency also has included in the EGRPRA review all rules over which NCUA has drafting authority, except for certain rules that pertain exclusively to internal operational or organizational matters, such as our Freedom of Information Act rule.

As our notice makes clear, however, credit unions also are subject to certain rules issued or administered by other regulatory agencies, such as the Consumer Financial Protection Bureau and the Department of the Treasury's Financial Crimes Enforcement Network. Because we have no independent authority or ability to change such rules, our notices—as do the interagency joint notices—simply advise that comments submitted to us but focused

[11] See http://www.ncua.gov/News/Pages/NW20150406NSPMSecondaryCapital.aspx.

on a rule administered by another agency will be forwarded to that other agency for appropriate consideration.

Regulatory Modernization Initiative

In 2011, Chairman Matz launched the agency's Regulatory Modernization Initiative. The initiative balances two principles:

- Safety and soundness—strengthening regulations necessary to protect credit union members and the Share Insurance Fund, and
- Regulatory relief—revising and removing regulations that limit flexibility and growth, without jeopardizing safety and soundness.

In implementing this initiative, NCUA has held regular in-person and online town-hall meetings to solicit feedback from stakeholders. These events have identified regulatory relief issues on which the agency has since acted.

During its first three years, the initiative resulted in 15 actions to cut red tape and provide lasting benefits to credit unions of all sizes.[12] Specifically, NCUA worked to ease eight regulations, providing regulatory relief to thousands of credit unions. NCUA also streamlined three processes, such as facilitating more than a thousand new low-income credit union designations and establishing an expedited process for examinations at smaller credit unions.[13] NCUA additionally issued four legal opinions, allowing more flexibility in credit union operations.

Earlier this year at the Credit Union National Association's Governmental Affairs Conference, Chairman Matz announced her continuing commitment to the Regulatory Modernization Initiative. Specifically, she said 2015 would be the year of regulatory relief.[14] Her speech described five areas in which NCUA will work to provide relief: supplemental capital, fields of membership, fixed assets, asset securitization, and member business lending.

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[12] See Appendix II for a complete list of these actions.

[13] A low-income credit union is one in which a majority of its membership (50.01 percent) qualifies as low-income members. Low-income members are those members who earn 80 percent or less than the median family income for the metropolitan area where they live, or the national metropolitan area, whichever is greater. In non-metropolitan areas, the qualification threshold is a median family income at or below 80 percent of the state median family income for non-metropolitan areas, or, if greater, the national median family income for non-metropolitan areas. Under the Federal Credit Union Act, the low-income designation offers certain benefits and regulatory relief, such as an exemption from the statutory cap on member business lending, eligibility for Community Development Revolving Loan Fund grants and low-interest loans, the ability to accept deposits from non-members, and authorization to obtain supplemental capital.

[14] See http://www.ncua.gov/News/Documents/SP20150309MatzGAC.pdf.

During their speeches at the same conference, NCUA Board Vice Chairman Rick Metsger and Board Member J. Mark McWatters also expressed support for providing credit unions with more regulatory relief.[15] This relief will help credit unions of all sizes compete in a rapidly evolving marketplace.

Rulemaking Process

In developing any regulation, NCUA strives to ensure the agency's rulemakings are reasonable and cost-effective. NCUA additionally conducts an analysis to support the agency's decisions in advance of regulatory actions. The analysis ensures regulatory choices are made after appropriate consideration of the likely consequences to the parties affected by the rulemaking.

NCUA's safety and soundness regulations protect credit unions, as well as strengthen the credit union system the agency supervises and insures.[16] These regulations reduce the likelihood of credit union failures and, in doing so, promote stability and protect the Share Insurance Fund.

Any loss to the Share Insurance Fund is ultimately borne by surviving credit unions, which may be required to pay increased premiums. As member-owned cooperatives, this means the members—who are the owners and consumers of the credit unions—may ultimately have to repay these costs. As the developments of the last decade have demonstrated, the cost of regulatory inaction can result in failures that impose a greater cost to credit unions and society than the cost of action.[17]

Through the public comment process, the NCUA Board gains insights on potential costs, unintended consequences, and alternative strategies directly from credit unions, as well as other interested stakeholders. The Board then uses this information to make adjustments before issuing a final rule. A good example of this process in action is NCUA's October 2013 final rule on emergency liquidity and contingency funding.

The proposed liquidity rule applied to all federally insured credit unions with more than $50 million in assets, but the public comment period yielded a number of important observations

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[15] See http://www.ncua.gov/News/Documents/SP20150309MetsgerGAC.pdf and http://www.ncua.gov/News/Documents/SP20150310McWattersGAC.pdf, respectively.

[16] NCUA has a number of regulations that address issues other than safety and soundness, such as those rules related to field of membership, the Community Development Revolving Loan Fund, payday alternative loans, the organization of federal credit unions, agency procedures, and examiner post-employment restrictions, among others.

[17] The collapse of five corporate credit unions during the 2007–2009 financial crisis best illustrates this point. To date, credit unions have paid $4.8 billion in assessments and experienced $5.6 billion in losses in the form of contributed capital. These costs incurred during the financial crisis reduced credit union earnings and assets and, as a result, during that time may have decreased interest paid on share deposits, increased loan rates, and constrained credit union services for their members.

about the compliance requirements associated with establishing emergency lines of credit. Based on this information, the NCUA Board reconsidered the balance between costs and benefits specifically for credit unions holding $50 million to $250 million in assets.

The final rule on emergency liquidity and contingency funding exempted credit unions with assets up to $250 million from establishing emergency lines of credit with the Federal Reserve's Discount Window, or NCUA's Central Liquidity Facility, or both. Instead, the Board only required credit unions of this size to develop contingency funding plans that clearly set out strategies for meeting emergency liquidity needs.

Examples of Scaled Regulation

In addition to adjusting the emergency liquidity and contingency funding rule, NCUA has recently scaled other regulations based on the asset size of the credit union. Examples of such tailored regulations include the agency's 2012 interest rate risk rule and the revised proposed risk-based capital rule issued in January.[18]

Interest Rate Risk Rule

NCUA's focus on interest rate risk management has been constant for more than 15 years, as evidenced by a steady issuance of guidance to examiners and credit unions on asset-liability management. Since 2010, interest rate risk management has been a heightened focus for NCUA, and it is again a primary supervisory focus for the agency in 2015.

NCUA's focus on interest rate risk exposure has increased due to the extraordinarily low level of interest rates and the overall lengthening of asset durations in the credit union system in recent years. NCUA is mindful that a period of rapidly rising rates could be a particularly challenging scenario for some credit unions. To mitigate this risk and maintain stable earnings, credit unions need to have policies in place to survive adverse rate environments.

These concerns led the NCUA Board to issue a final rule three years ago aimed at managing interest rate risk. Generally, the rule categorizes credit unions based on size, which is correlated to risk exposure, to determine the need to adopt a written policy on interest rate risk. Consistent with the Board's policy to exempt small credit unions from regulations when prudent, the size and exposure criteria in the interest rate risk rule exempt credit unions with less than $50 million in assets, while protecting the Share Insurance Fund by covering most of the system's assets.

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[18] See Appendix III for a more complete listing of efforts to scale regulations and examinations and to provide assistance designed to address the unique circumstances of smaller credit unions.

The NCUA Board exempted smaller credit unions because they customarily have very low interest-rate-risk profiles as they are not as active in residential mortgage lending or long-term investing.[19] Also, smaller credit unions typically have much higher capital levels and hold relatively more cash and short-term investments on their balance sheets.[20]

Revised Proposed Risk-Based Capital Rule

After reviewing 2,056 comments on the original risk-based capital proposal, the NCUA Board issued a revised proposed rule in January. NCUA's primary goals for the revised proposed risk-based capital rule remain the same:

- To prevent or mitigate losses to the Share Insurance Fund by having a better calibrated, meaningful, and more forward-looking capital requirement to ensure credit unions can continue to serve their members during economic downturns without relying on government intervention or assistance, and

- To modernize the risk-based capital calculations and framework, in accordance with the Federal Credit Union Act's directives.

The new proposal significantly narrowed the proposed rule's scope by redefining "complex" credit unions. Under this rulemaking, the NCUA Board has proposed to limit the risk-based capital requirement to credit unions with more than $100 million in assets, rather than the $50 million threshold contained in the current rule and the earlier proposal.

By increasing the asset threshold, the revised proposed rule exempts more than three-quarters of credit unions. As a result, the revised proposed rule covers 1,455 credit unions that hold 89 percent of the system's assets.[21] In comparison, the original proposal covered 2,237 credit unions representing 94 percent of the system's assets.[22] The revised proposal also would result in the downgrade of fewer credit unions.[23]

As requested by stakeholders, including many members of the House Financial Services Committee, the revised proposed rule includes significant changes to the risk weights for investments, real estate loans, member business loans, corporate credit unions, and credit union service organizations. The risk weights contained in the new proposal are generally

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[19] As of December 31, 2014, real estate loans at credit unions with more than $50 million in assets accounted for 33.4 percent of total assets, compared to 15.9 percent at credit unions below this threshold.

[20] As of December 31, 2014, credit unions with $50 million or less in assets maintained cash and short-term investment balances at 22.4 percent of total assets, compared to 13.2 percent for credit unions above this threshold.

[21] Data as of December 31, 2013.

[22] Same as above.

[23] The reformulated risk-based capital proposal would downgrade the capital status of just 19 of 1,455 covered credit unions, based on data as of December 31, 2013. For more information about the revised risk-based based capital proposed rule, see http://www.ncua.gov/Resources/Pages/risk-based-capital-resources.aspx.

comparable to or more favorable than the risk weights applied to banks by federal banking agencies.

Finally, the revised proposed rule extends the implementation date to January 1, 2019. This date aligns with the risk-based capital rule implementation deadline for banks. It also allows credit unions covered under the rule ample time to prepare for the change.

The extended comment period on the revised proposed risk-based capital rule closes on April 27, 2015.

Other Regulatory Relief Proposals under Consideration

Going forward, NCUA is already working to provide additional regulatory relief for credit unions to fulfill Chairman Matz's vision of making 2015 the year of regulatory relief.

NCUA is drafting a proposal to modernize our member business lending rule. The primary changes being considered involve removing prescriptive underwriting criteria and other outdated restrictions, thereby eliminating the need for credit unions to request waivers from NCUA to make certain types of business loans.

In April 2014, the NCUA Board also issued a proposed rule to define more clearly which associational groups do and do not qualify for membership in a federal credit union. The proposed rule would provide automatic approval for seven types of groups. Thus, credit unions would receive regulatory relief as they would no longer be required to devote resources to the process for approving additions to their fields of membership. The change also would enable NCUA to more efficiently use its own resources.

To facilitate greater access to credit union membership, several commenters suggested additional categories of well-established associational groups that also should be considered for automatic approval. The NCUA Board has carefully reviewed these suggestions and is expected to consider a final rule at its open meeting next week. This final rule will include substantially more regulatory relief than the proposed rule as NCUA responds to the comments received. For example, the Board will likely add five additional types of groups that will automatically satisfy the associational common bond provisions.

NCUA is additionally working to fine-tune a proposed rule on asset securitization. Approved in June 2014, this proposal would allow qualified federal credit unions to securitize loans they have originated under certain conditions. Once finalized, this rule would provide these federal credit unions with greater flexibility to manage interest rate and liquidity risks.

Finally, in March 2015, the NCUA Board proposed to eliminate the 5-percent fixed-assets cap. The proposed rule also would remove provisions in the current rule relating to waivers from the aggregate limit, simplify the rule's partial occupancy requirements, and move

oversight of federal credit union fixed-assets ownership from regulation to the supervisory process. When finalized, this rule will allow federal credit unions to make business decisions on upgrading technology, updating facilities, or making other purchases without filing waivers and without NCUA's involvement in day-to-day business decisions.

Improvements in the Examination Program

Beyond providing targeted relief by issuing regulatory exemptions and adopting tailored rules, NCUA is providing regulatory relief by cutting burdens in the examination process.

Small Credit Union Examination Program

Since 2002, NCUA has followed a risk-focused exam program. This approach is designed to efficiently allocate agency resources to credit unions and areas of operations exhibiting the greatest potential risk exposure to the Share Insurance Fund. The program relies on examiner judgment to determine the areas needing review. Over time, NCUA has adjusted this approach by adding minimum scope requirements and establishing the *National Supervision Policy Manual* to ensure consistency of supervisory actions across the country.

While the risk-based examination program has generally worked well, in 2011 we determined the resources used to complete examinations were not in balance with the credit union system's risks. NCUA was spending more exam hours on the smallest credit unions rather than the largest credit unions that have the greatest concentration of the system's assets and the greatest potential risk exposure to the Share Insurance Fund.

NCUA has since moved to concentrate supervision on credit union activities posing the most risk. We recognized larger, more complex credit unions require more attention, so we began streamlining exams for the smallest credit unions and deploying examiners where their work will be most effective in protecting the Share Insurance Fund.

NCUA now has in place a targeted, streamlined examination program for financially and operationally sound federal credit unions with less than $30 million in assets. Through the Small Credit Union Examination Program, NCUA spends less time on average in small, well-managed federal credit unions. This decreased examination burden reflects a reduced overall scope but is more precisely focused on the most pertinent areas of risk in small credit unions—lending, recordkeeping, and internal control functions.

NCUA subsequently expanded the program. NCUA regions now have the discretion to choose a defined-scope examination for federal credit unions with between $30 million to $50 million in total assets that received a composite CAMEL rating of 1, 2, or 3 at their last

examination.[24] NCUA implemented the new procedures during the first quarter of 2015. For larger, more complex credit unions, NCUA will continue to perform risk-focused exams.

Broader Examination Reforms

NCUA is further working to streamline the examination process for all credit unions by harnessing technology. Improvements in computers, software, and security are allowing NCUA to design a new Automated Integrated Regulatory Examination System and revise our Call Report system to improve off-site monitoring capabilities and thereby potentially reduce the overall time NCUA spends onsite inside credit unions conducting examinations.

To improve consistency in the way field staff develop and use documents of resolution, NCUA also revised our policy and procedures in 2013 to clarify how and when documents of resolution should be used.[25] The new policy states documents of resolution should only be used to address issues significant enough that a credit union's failure to correct the problem would necessitate the examiner recommending an enforcement action. In addition, examiners must cite the appropriate law, regulation, or authoritative NCUA policy when including an issue as a finding or document of resolution in the examination report.

These procedural changes have resulted in clearer expectations for credit unions and NCUA field staff, as well as greater consistency nationwide in the examination process. Credit unions also have generally supported the change. As a result of these changes and an improved economy, the agency has experienced a decline in the number of documents of resolution issued.

Regulatory Relief Legislation

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

NCUA is very appreciative of the House Financial Services Committee's efforts during the 113th Congress to enact into law the Credit Union Share Insurance Fund Parity Act by Congressmen Royce and Perlmutter and the American Savings Promotion Act by Congressman Kilmer.[26] The first law allows federally insured credit unions to offer the

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[24] The CAMEL rating system is based upon an evaluation of five critical elements of a credit union's operations: Capital adequacy, Asset quality, Management, Earnings, and Liquidity. The CAMEL rating system is designed to take into account and reflect all significant financial, operational, and management factors that examiners assess in their evaluation of a credit union's performance and risk profile. CAMEL ratings range from 1 to 5, with 1 being the highest rating.

[25] Examiners use documents of resolution to outline plans and agreements reached with credit union officials to reduce areas of unacceptable risk. An area of unacceptable risk is one for which management does not have the proper structure for identifying, measuring, monitoring, controlling, and reporting risk.

[26] P.L. 113-252 and P.L. 113-251, respectively.

same level of insurance on deposits as banks and thrifts for lawyers' trust accounts. The second law permits federally insured financial institutions to offer prize-linked accounts to promote saving.

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

Regulatory Flexibility

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

The Federal Credit Union Act contains a number of hard-coded provisions that limit NCUA's ability to revise regulations and provide relief to such credit unions. Examples include limitations on the eligibility for credit unions to obtain supplemental capital, field-of-membership restrictions, curbs on investments in asset-backed securities, and the 15-year loan maturity limit, among others.[27]

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

As previously noted, NCUA continues to modernize existing regulations with an eye toward balancing requirements appropriately with the relatively lower levels of risk smaller credit unions pose to the credit union system. By allowing NCUA discretion on scale and timing to implement new laws, we could more flexibly mitigate the cost and administrative burdens of these smaller institutions while balancing consumer and prudential priorities.

Field-of-Membership Requirements

The Federal Credit Union Act currently permits only federal credit unions with multiple common-bond charters to add underserved areas to their fields of membership. We recommend Congress act to modify the Federal Credit Union Act to give NCUA the authority to streamline field-of-membership changes and permit all federal credit unions to grow their membership by adding underserved areas.

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[27] 12 U.S.C. 1751 and what follows.

Allowing federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could eventually enable more credit unions to participate in the programs offered through the congressionally established Community Development Financial Institutions Fund, thus increasing the availability of credit and savings options in distressed areas.[28]

Congress also may want to consider other field-of-membership statutory reforms. For example, Congress could allow federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, Congress could simplify the "facilities" test for determining if an area is underserved.[29] This issue is one that the field-of-membership working group created by Chairman Matz also is exploring.

The internal working group additionally is examining ideas for other legislative or policy changes to facilitate access to credit unions and ease credit union compliance burdens. NCUA stands ready to work with the Committee on these ideas, as well as other options to provide consumers more access to affordable financial services through credit unions.

Member Business Lending

NCUA reiterates the agency's long-standing support for legislation to adjust the member business lending cap, such as H.R. 1188, the Credit Union Small Business Jobs Creation Act, sponsored by Congressmen Royce and Meeks. This bipartisan bill contains appropriate safeguards to ensure NCUA can protect safety and soundness as qualified credit unions gradually increase member business lending.

For federally insured credit unions, the Federal Credit Union Act limits member business loans to the lesser of 12.25 percent of assets or 1.75 times net worth, unless the credit union qualifies for a statutory exemption.[30] For smaller credit unions with the membership demand and the desire to serve the business segments of their fields of membership, the restriction makes it very difficult or impossible to successfully build a sound member business lending program. As a result, many credit unions are unable to deliver commercial lending services cost effectively, which denies small businesses in their communities access to an affordable source of credit and working capital.

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

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

[30] 12 U.S.C. 1757a.

These credit unions miss an opportunity to support the small business community and to provide a service alternative to the small business borrower. Small businesses are an important contributor to the local economy as providers of employment and as users and producers of goods and services. NCUA believes credit union members that are small business owners should have full access to financial resources in the community, including credit unions, but this is often inhibited by the statutory cap on member business loans.

NCUA additionally supports H.R. 1422, the Credit Union Residential Loan Parity Act, which Congressmen Royce and Huffman have recently introduced. This bipartisan legislation addresses a statutory disparity in the treatment of certain residential loans made by credit unions and banks.

When a bank makes a loan to purchase a 1- to 4-unit, non-owner-occupied residential dwelling, the loan is classified as a residential real estate loan. If a credit union were to make the same loan, it is classified as a member business loan; therefore, it is subject to the member business lending cap. To provide parity between credit unions and banks for this product, H.R. 1422 would exclude such loans from the cap. The legislation also contains appropriate safeguards to ensure NCUA will apply strict underwriting and servicing standards for these loans.

Supplemental Capital

NCUA supports legislation to allow more credit unions to access supplemental capital, such as H.R. 989, the Capital Access for Small Businesses and Jobs Act. Introduced by Congressmen King and Sherman, this bill would allow healthy and well-managed credit unions to issue supplemental capital that will count as net worth. This bipartisan legislation would result in a new layer of capital, in addition to retained earnings, to absorb losses at credit unions.

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

A credit union's inability to raise capital outside of retained earnings limits its ability to expand its field of membership and to offer greater options to eligible consumers. Consequently, NCUA has previously encouraged Congress to authorize healthy and well-managed credit unions to issue supplemental capital that will count as net worth under conditions determined by the NCUA Board. Enactment of H.R. 989 would lead to a stronger capital base for credit unions and greater protection for taxpayers.

Vendor Authority

Finally, NCUA requests that the House Financial Services Committee consider legislation to provide the agency with examination and enforcement authority over third-party vendors—including credit union service organizations, or CUSOs for short. Obtaining this authority is the agency's top legislative priority.

This authority would provide a small measure of regulatory relief for credit unions. The ability to address weaknesses at the source (service provider) could easily save NCUA and credit unions time and valuable resources by eliminating the time needed to mitigate the same issue repeatedly at hundreds of credit unions. In other words, credit unions would no longer be stuck in the middle of trying to resolve problems between their vendors and NCUA. Further, NCUA could remove current regulations requiring credit unions to maintain and modify contracts with CUSOs to govern key aspects of these operations, like accounting standards and examination access to financial information.

The Government Accountability Office has noted that NCUA has a limited ability to assess the risks third-party vendors, including CUSOs, pose for credit unions and ultimately the Share Insurance Fund, and to respond to any problems.[31] NCUA may only examine CUSOs and vendors with their permission and cannot enforce any recommended corrective actions. This lack of authority stands in contrast to the powers of the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and most state regulators.

The types of services CUSOs and other third-party vendors provide credit unions vary widely depending on the size and complexity of the credit union.[32] Thus, the variety of potential risks to a credit union, its members, and the Share Insurance Fund depend on the services provided.

In requesting vendor authority, NCUA seeks to close a regulatory blind spot: non-transparent, ongoing risks to the credit union system from certain types of CUSOs and third-party vendors that either originate loans or are business technology providers or payment system providers. Without vendor authority, NCUA cannot accurately assess the actual risk present in the credit union system and whether current CUSO or third-party vendor risk-mitigation strategies are adequate and can effectively protect the system from a propagated contagion.

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[31] See http://www.gao.gov/new.items/d0491I.pdf.

[32] These services include data processing, item processors, loan servicing, ATM networks, insurance products, branch networks, student loan originations, business loan originations, mortgage loan originations, electronic transaction services, payroll processing, and credit card originations, among others.

The gaps in NCUA's supervision program created by the lack of vendor authority are material. In all, approximately 46 percent of credit unions receive service from a credit union system-only vendor. This leaves thousands of credit union clients, billions in assets, and millions of their members potentially exposed. Furthermore, nearly all of the core technology service providers exclusively serving credit unions have declined a voluntary review by NCUA in recent years.

Even where CUSOs agree to submit to NCUA reviews, without enforcement authority they are free to reject NCUA's recommendations to implement appropriate corrective actions to mitigate identified risks. Moreover, NCUA may not receive information about a troubled vendor as early as other regulators, because we do not have comparable authority, and our ability to more completely disclose information with credit unions is limited.

NCUA has issued supervisory guidance urging credit unions to improve due diligence in third-party vendor relationships because of the recurring problems uncovered during the examination process. The agency has had to issue repeated guidance because many credit unions have failed to perform third-party due diligence well. In part, this is due to their limited influence or authority over vendors. This may also be attributable to staffing issues and lack of internal expertise within credit unions.

NCUA is especially concerned about our ability to effectively mitigate cybersecurity threats absent third-party vendor authority. Our cybersecurity concerns predominantly relate to cyber-threats against financial services vendors, some of which may exclusively serve credit unions and large numbers of them, or that have access to extensive personally identifiable information for millions of credit union members. NCUA needs to exercise oversight to ensure proper and robust safeguards are in place to protect such systems and data. With respect to such technology service providers, NCUA would seek information related to their cybersecurity safeguards, ongoing vulnerability assessments, and mitigation strategies in the event of being compromised.

Today, the top five technology service providers serve more than half of all credit unions representing 75 percent of the credit union system's assets. Thus, a failure of even one vendor represents potential risk to the Share Insurance Fund. The potential for losses are not hypothetical. Since 2008, nine CUSOs have caused more than $300 million in direct losses to the Share Insurance Fund and led to the failures of credit unions with more than $2 billion in aggregate assets. In one such example, one CUSO caused losses in 24 credit unions, some of which failed.

These vendors also provide an array of products and services to credit unions, and like other small financial institutions, credit unions rely heavily on third parties in this area. Credit unions often use common third-party services designed specifically for small institutions. When third-party vendors perform functions that include online banking, transaction processing, fund transfers, and loan underwriting, the data are being stored on these

vendors' servers. In addition, vendors that process funds, such as shared branching networks, can create gaps in anti-money laundering oversight.

Finally, the lack of transparency of information needed to evaluate risk is compounded by the fact that the use of third-party vendors is growing and vendors themselves are consolidating. Data from the fourth quarter of 2014 show that credit unions using the services of a CUSO accounted for $992.4 billion in assets or 88 percent of system assets. This figure is up from 79 percent of assets at year-end 2009, but it does not include third-party vendors that are not CUSOs. Thus, the actual number could be higher.

NCUA's past experience informs how the agency would utilize enhanced vendor authority today. From 1998 to 2001, Congress granted NCUA the authority it currently seeks out of concerns with Y2K issues. At that time, the agency redeployed existing resources without incurring significant costs. Today, the trend is to replace existing examiners with specialists, so to the extent that any additional specialists are necessary with the new authority, there would only be incremental costs.

If granted this authority, Chairman Matz also has publicly indicated that there would be no material change in NCUA's budget. Instead of regularly examining every third party, NCUA would focus on examining those vendors with red flags or posing greater risks. When material or widespread safety and soundness issues are identified, we would have the authority to mitigate the risk and decrease losses for the Share Insurance Fund.

NCUA has developed a legislative proposal which we believe would afford the agency the appropriate statutory authority to address these problems. NCUA stands ready to work with the Committee on legislation to effectuate the necessary changes so that all credit unions can responsibly and effectively utilize the services of CUSOs and third-party vendors.

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

APPENDIX I

Historical Performance by Asset Class

	2014, Fourth-Quarter Median				
	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
Loan Growth Rate (annual)	0.35%	2.23%	4.44%	6.35%	9.61%
Asset Growth Rate (annual)	-0.52%	1.56%	2.52%	3.67%	4.99%
Membership Growth Rate (annual)	-1.52%	-0.86%	0.05%	0.96%	3.29%
Loan-to-Share Ratio	57.11%	55.58%	61.70%	70.36%	75.71%
Net Worth Ratio	14.16%	11.51%	10.69%	10.33%	10.51%
Return on Average Assets Ratio	0.09%	0.24%	0.41%	0.53%	0.74%
Delinquency Ratio	1.26%	0.85%	0.86%	0.77%	0.69%
Non-Interest Expenses-to-Total Assets Ratio	3.54%	3.49%	3.76%	3.72%	3.32%
Full-Time Equivalent Employees	2	7	22	45	149

	5-Year Median				
	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
Loan Growth Rate (annual)	-0.25%	0.70%	2.11%	3.20%	5.45%
Asset Growth Rate (annual)	0.86%	3.03%	3.90%	4.27%	5.38%
Membership Growth Rate (annual)	-1.49%	-0.63%	0.45%	1.12%	2.87%
Loan-to-Share Ratio	56.68%	57.03%	62.39%	68.42%	71.43%
Net Worth Ratio	14.06%	11.57%	10.54%	10.07%	9.98%
Return on Average Assets Ratio	-0.06%	0.18%	0.35%	0.45%	0.69%
Delinquency Ratio	1.85%	1.13%	1.04%	1.04%	1.01%
Non-Interest Expenses-to-Total Assets Ratio	3.79%	3.72%	3.84%	3.81%	3.45%
Full-Time Equivalent Employees	2	7	21	43	139

	10-Year Median				
	Less than $10 million	$10 million to $50 million	$50 million to $100 million	$100 million to $250 million	Over $250 million
Loan Growth Rate (annual)	-0.01%	1.98%	3.66%	4.93%	6.63%
Asset Growth Rate (annual)	0.34%	3.19%	4.76%	5.36%	6.56%
Membership Growth Rate (annual)	-1.40%	-0.39%	0.70%	1.34%	2.88%
Loan-to-Share Ratio	64.67%	64.35%	68.94%	73.73%	76.85%
Net Worth Ratio	15.03%	12.39%	11.12%	10.52%	10.31%
Return on Average Assets Ratio	0.09%	0.30%	0.43%	0.44%	0.61%
Delinquency Ratio	2.20%	1.22%	1.10%	1.03%	0.95%
Non-Interest Expenses-to-Total Assets Ratio	3.86%	3.91%	4.00%	4.03%	3.56%
Full-Time Equivalent Employees	2	7	20	43	131

APPENDIX II

National Credit Union Administration
Regulatory Modernization Initiative
2011–2014 Results

NCUA ACTIONS	BENEFITS
IMPROVED RULES	
Modernized Definition of "Small" Credit Unions	• Expanded NCUA's consideration of regulatory exemptions for credit unions with assets of less than $50 million, up from the previous $10 million. • Exempted two-thirds of the entire credit union system from NCUA rules on risk-based net worth and interest rate risk management. • Eased the compliance requirement for small credit unions to access emergency liquidity. • Doubled the number of credit unions receiving special consideration for regulatory relief in future NCUA rulemakings.
Eased Troubled Debt Restructurings	• Encouraged credit union loan modifications and ended manual reporting. • Prevented unnecessary foreclosures. • Kept more credit union members in their homes throughout the crisis.
Expanded Rural Districts	• Raised potential membership for federal credit unions in rural districts from a hard cap of 200,000 residents to a sliding scale: 250,000 residents or 3 percent of the state population, whichever is larger. • Permitted federal credit unions to serve rural districts and Indian reservations in states experiencing extraordinary population growth, as well as in smaller states.
Authorized "Plain Vanilla" Derivatives	• Encouraged qualified federal credit unions to use "plain vanilla" derivatives to reduce risks. • Permitted approved federal credit unions to continue mortgage lending while offsetting interest rate risk. • Protected the credit union system by providing an extra buffer against potential losses at large credit unions.
Approved Treasury Inflation-Protected Securities	• Offered federal credit unions an additional investment backed by the federal government with zero credit risk. • Provided returns indexed to inflation rates rather than interest rates.
Established Charitable Donation Accounts	• Empowered federal credit unions to safely pool investments designed to benefit national, state, or local charities.
Proposed Eliminating Fixed Assets Cap	• Eliminated federal credit unions' 5-percent cap on fixed assets. • Empowered federal credit unions to make their own business decisions on purchases of land, buildings, office equipment, and technology.
Proposed Asset Securitization	• Authorized qualified federal credit unions to securitize their own assets. • Offered an additional tool to manage interest rate and liquidity risks.

NCUA
National Credit Union Administration

NCUA ACTIONS	BENEFITS
STREAMLINED PROCESSES	
Low-Income Credit Union Designation	• Implemented an "opt-in" process whereby eligible credit unions can simply say "yes" to receive the low-income designation. • More than doubled the number of low-income designations, reaching more than 2,200 credit unions serving 27 million members. • Low-income credit unions are authorized by statute to expand member business lending beyond the statutory cap, obtain supplemental capital, raise non-member deposits, and apply for Community Development Revolving Loan Fund grants and loans.
Blanket Waivers	• Released guidance encouraging credit unions to apply for blanket waivers for member business loans meeting certain conditions. • Eliminated the requirement for many business owners to pledge personal guarantees against loans with high-value collateral based on sound underwriting principles. • Blanket waivers eliminated the need for credit unions to apply for loan-by-loan waivers.
Expedited Examinations	• Created an expedited exam process for well-managed credit unions with CAMEL ratings of 1, 2, or 3 and assets of less than $30 million, with the program expanding to $50 million in 2015. • Enables these credit unions to dedicate more resources to serving members.
ISSUED LEGAL OPINIONS	
Extended Loan Maturities	• Permitted loan maturities up to 40 years after loan modifications. • Significantly reduced monthly payments for borrowers in need.
Expanded Vehicle Fleets	• Modernized the definition of "fleet" from two to five vehicles for member business loans. • Provided regulatory relief and expanded access to credit for small businesses and startups.
Modernized Service Facilities	• Included full-service video tellers in the definition of federal credit union service facilities. • Empowered federal credit unions to expand services in underserved areas without necessarily purchasing more brick-and-mortar branches.
Changing Charters in Mergers	• Permitted credit unions to change charters to facilitate voluntary mergers. • Retained credit union service for members of merging credit unions.

APPENDIX III

Examples of Efforts to Scale Regulation and Support Small Credit Unions

Rule/Program	Description
Small Credit Union Definition	• A credit union with less than $50 million in assets is excluded from certain NCUA rules. • NCUA also must specifically consider the potential regulatory burden and alternatives for small credit union in any rulemaking. • NCUA will review the small credit union definition in 2015 and then every three years. The review will keep the definition up-to-date as the credit union system evolves.
Interest Rate Risk	• Credit unions with $50 million or less in assets are excluded.
Liquidity and Contingency Funding	• Credit unions with less than $50 million in assets must maintain a basic written liquidity policy. • Credit unions with $50 million and over in assets must establish and document a contingency funding plan. • Credit unions with $250 million and over in assets also must establish and document access to at least one contingent federal liquidity source.
Voluntary Liquidations Creditor Notices	• Federal credit unions with less than $1 million in assets are exempt. • Federal credit unions with less than $50 million in assets but more than $1 million in assets are required to place just one creditor notice.
Risk-Based Capital	• Credit unions with less than $50 million in assets are excluded under the existing risk-based net worth rule. • The revised proposed risk-based capital rule would exempt credit unions with less than $100 million in assets.
One-on-One Consulting Services	• Credit unions with less than $50 million in assets are eligible to apply for customized consulting from NCUA's Office of Small Credit Union Initiatives.
Net Worth Restoration Plans	• Credit unions with less than $10 million in assets must receive NCUA assistance in developing net worth restoration plans, if the credit union requests.
New Credit Union Support	• Federal credit unions with less than $10 million in assets and less than 10 years in operation are eligible for NCUA consulting assistance. • Federal credit unions with less than $10 million in assets must receive NCUA assistance with business plan revisions, if the credit union requests.
Generally Accepted Accounting Principles	• Credit unions with assets under $10 million are exempted from complying with the reporting requirements of Generally Accepted Accounting Principles.

Rule/Program	Description
Additional Small Credit Union Assistance	• NCUA's Office of Small Credit Union Initiatives additionally offers: partnership opportunities with other government, nonprofit, and industry leaders; resources such as white papers, guides, and manuals; and training, including webinars and videos.
Audits	• Credit unions holding between $10 million to $500 million in assets may choose one of three lower-cost alternatives for their annual financial statement audits: a balance sheet audit, a report on examination of internal control over Call Reporting, or an Audit per the Supervisory Committee Guide.
Truth in Savings Act	• Non-automated credit unions with $2 million or less in assets after subtracting any non-member deposits are exempted from the Truth in Savings Act.
Operating Fees	• Federal credit unions with less than $1 million in assets are exempted from the annual operating fee that funds federal credit union regulation. • Federal credit unions with more than $1 million in assets pay annual operating fees scaled to size.
Small Credit Union Examination Program	• Operationally sound federal credit unions with less than $10 million in assets received streamlined exams averaging 40 hours. • Operationally sound federal credit unions with assets between $10 million and $30 million receive streamlined examinations averaging 65 hours.
Federally Insured, State-Chartered Credit Union Examinations	• Federally insured, state-chartered credit unions with less than $250 million in assets are generally not subject to an annual onsite NCUA examination.
Electronic Filing	• To assist in the migration to electronic filing of quarterly Call Reports, NCUA helped manual filers obtain computers and assigned an Economic Development Specialist to work with small credit unions identified as filing manually each quarter.

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Statement by

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Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions and Consumer Credit

of the

Committee on Financial Services

U.S. House of Representatives

Washington, D.C.

April 23, 2015

Introduction

Chairman Neugebauer, Ranking Member Clay, and other members of the subcommittee, I appreciate the opportunity to testify on the important topic of community financial institutions and regulatory relief for these institutions. Community banks are a critical component of our financial system and economy. They reduce the number of underbanked citizens by providing banking services that may otherwise go unmet, particularly in rural areas. They also are especially effective at meeting the credit needs of their surrounding communities. Because of their firsthand knowledge of the local economic landscape, they are better prepared to look beyond traditional credit factors to consider unique borrower characteristics when making credit decisions. Having begun my career more than 30 years ago as a community bank examiner at the Federal Reserve Bank of Kansas City and eventually becoming the officer in charge of bank supervision at the Reserve Bank, I have seen firsthand how critical it is that we balance effective supervision and regulation to ensure that community banks operate in a safe and sound manner, while not subjecting these institutions to unnecessary regulatory requirements that could constrain their capacity to lend to the communities they serve. In my testimony, I will discuss measures taken by the Federal Reserve to calibrate regulations, policies, and supervisory activities to the risks at community banking organizations.[1]

Condition of Community Banks

The Federal Reserve supervises approximately 860 state-chartered community banks that have chosen to be members of the Federal Reserve System (referred to as state member banks). In addition, the Federal Reserve supervises approximately 4,400 top-tier bank holding companies

[1] For supervisory purposes, the Federal Reserve uses the term "community banking organization" to describe a state member bank and/or holding company with $10 billion or less in total consolidated assets.

and approximately 300 top-tier savings and loan holding companies, most of which operate small community thrifts.

The overall condition of community banks has improved significantly in the time since the recent financial crisis. The number of banks on the Federal Deposit Insurance Corporation's (FDIC) "Problem List" fell from a peak of 888 at the end of the first quarter of 2011, to 291 at year-end 2014.[2] Despite that significant decline, the number of problem banks compares unfavorably with historical numbers of less than 100, on average, in the years prior to the crisis.

Overall capital levels and asset quality at community banks have improved since the financial crisis.[3] At year-end 2014, the aggregate tier 1 risk-based capital ratio for community banks was 14.5 percent, up from a low of 12.0 percent at year-end 2008, and the aggregate leverage ratio was 10.5 percent, up from a low of 9.2 percent at year-end 2009. Noncurrent loans represented 1.4 percent of total loans at year-end 2014, down significantly from 4.1 percent at year-end 2009, while net charge-offs as a percent of total loans were down to 0.3 percent at year-end 2014 from a high of 1.6 percent at year-end 2009. Moreover, community banks saw an uptick in lending in 2014, with annual loan growth of 6.5 percent at year-end 2014. This is in stark contrast to the period from 2009 through 2011, when total loans declined each year.

Banks' earnings have benefited in the past couple of years from reductions in provision expenses for loan and lease losses. Yet, community bank earnings continue to experience considerable pressure from historically low net interest margins, and many community banks report concerns about their prospects for continued growth and profitability.

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[2] See FDIC, Quarterly Banking Profile, Fourth Quarter 2014, www2.fdic.gov/qbp/2014dec/qbp.pdf.

[3] Figures are aggregate statistics based on quarterly Consolidated Reports of Condition and Income (commonly called the Call Report) data filed by all insured commercial banks with assets of $10 billion or less. See www.ffiec.gov/ffiec_report_forms.htm.

The Federal Reserve's Approach to Supervising and Regulating Community Banks

The Federal Reserve uses a risk-focused approach to supervision, with activities directed toward identifying the areas of greatest risk to banking organizations or consumers and assessing the ability of the organizations' management processes to identify, measure, monitor, and control those risks. Under our risk-focused supervision framework, bank examination and holding company inspection procedures are tailored to each banking organization's asset size, complexity, risk profile, and condition. The supervisory program for all institutions, regardless of size and complexity, entails both off-site and on-site work, including development of supervisory plans, review of financial data, transaction testing, documentation of examination results, assignment of supervisory ratings, and communication of examination findings to the bank and its board of directors.

There are distinct differences between the supervision program of a large, complex banking organization and a small, non-complex bank. For one, a large banking organization generally has a dedicated supervisory team, supported by risk specialists, whereas a small bank is generally visited by examiners only every 12 to 18 months. Furthermore, if a bank is engaging in nontraditional or higher-risk activities, our supervision program typically requires greater scrutiny and a higher level of review of specific transactions and risk areas. Conversely, if a well-managed bank's activities are lower risk, we adjust our expectations for examiners to a lower level of review. In this way, we alleviate examination burden on community banks with histories of sound performance and modest risk profiles.

Consistent with the Federal Reserve's risk-focused approach to supervision and when permitted by law, the Federal Reserve scales supervisory rules and guidance in a way that applies

the most stringent requirements to the largest, most complex banking organizations that pose the greatest risk to the financial system. We work within the constraints of the law to draft rules and guidance so as not to subject community banks to requirements that are not commensurate with their risks and that would be unduly burdensome for these institutions to implement. We recognize that the cost of compliance can be disproportionally greater on smaller institutions versus larger institutions, as community banks have fewer staff available to help comply with additional regulations. Therefore, we carefully consider the need to establish new requirements to safeguard the safety and soundness of the financial system against the burden on banks to implement new requirements.

Many recently established rules have been tailored to apply the strictest requirements to only the largest, most complex banking organizations. One such example is the capital rule, issued in 2013, where many of the requirements do not apply to community banks.[4] These requirements include the countercyclical capital buffer, supplementary leverage ratio, trading book reforms, capital requirements for credit valuation adjustments, and disclosure requirements. Community banks also are not subject to additional enhanced standards that large banking organizations face related to capital plans, stress testing, liquidity and risk management requirements, and the systemically important financial institution surcharge.

The Federal Reserve has made a concerted effort to communicate clearly to both community bankers and examiners about new requirements that are applicable to community banks. We provide a statement at the top of each Supervision and Regulation letter and each

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[4] Board of Governors of the Federal Reserve System, "Federal Reserve Board Approves Final Rule to Help Ensure Banks Maintain Strong Capital Positions," press release, July 2, 2013, www.federalreserve.gov/newsevents/press/bcreg/20130702a.htm.

Consumer Affairs letter that clearly indicates which banking entity types are subject to the guidance. These letters are the primary means by which the Federal Reserve issues supervisory and consumer compliance guidance to bankers and examiners, and this additional clarity allows community bankers to focus efforts only on the supervisory policies that are applicable to their banks. Also, to assist community banks in understanding how new complex rules could possibly affect their business operations, the federal banking agencies have issued supplemental guides that focus on rule requirements that are most applicable to community banks. For example, the federal banking agencies issued supplemental guides for the 2013 capital rule, as well as the Volcker rule issued in December 2013.[5]

Coordination with the Other Banking Agencies

In order to help ensure that its supervision program is not unduly burdensome, the Federal Reserve also works closely with its colleagues at the other federal banking agencies and the state banking agencies to ensure that our supervisory approaches and methodologies are consistent and complementary. The agencies also work cooperatively to coordinate the examination of institutions subject to the supervision of more than one agency. For instance, on the resolution of a problem bank or thrift, the FDIC, as the insurer of depository institutions, has backup examination authority and coordinates with the primary federal bank regulator (either the Federal Reserve for state member banks or the Office of the Comptroller of the Currency (OCC) for national banks and federal thrifts) and as applicable with the state banking department on its

[5] Board of Governors of the Federal Reserve System, FDIC, and OCC, "New Capital Rule: Community Bank Guide," July, 9, 2013, www.federalreserve.gov/bankinforeg/basel/files/capital_rule_community_bank_guide_20130709.pdf; and Board of Governors of the Federal Reserve System, FDIC, and OCC, "The Volcker Rule: Community Bank Applicability," December 10, 2013, www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a4.pdf.

participation on an examination. The Federal Reserve and the FDIC also coordinate the examination of state banks with the responsible state banking department. As the supervisor for holding companies, the Federal Reserve coordinates its examination activities with the OCC and the FDIC when the holding company and the bank or thrift subsidiary share risk-management functions.

The Dodd-Frank Act requires that the Federal Reserve and the Consumer Financial Protection Bureau (CFPB) coordinate aspects of their consumer compliance supervision of insured depository institutions and their affiliates, including scheduling of examinations, providing reciprocal opportunities to comment upon reports of examination prior to issuance, and reciprocally providing final reports of examination after issuance. In May 2012, the Federal Reserve and the other federal banking agencies entered into a Memorandum of Understanding on Supervisory Coordination (MOU) with the CFPB.[6] The MOU establishes arrangements for coordination and information sharing among the parties. The Dodd-Frank Act also requires the CFPB to consult with the appropriate federal banking agencies before proposing rules and during the comment process.

Through the work of the various Federal Financial Institutions Examination Council's (FFIEC) task forces and subcommittees, staffs of the agencies meet to discuss the implementation of supervisory guidance and to develop common examination approaches and regulatory reports.[7] For example, the FFIEC member agencies are coordinating various work

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[6] Board of Governors of the Federal Reserve System, CFPB, FDIC, National Credit Union Administration (NCUA), and OCC, "Agencies Sign Memorandum of Understanding on Supervisory Coordination," press release, June 4, 2012, www.federalreserve.gov/newsevents/press/bcreg/20120604a.htm.

[7] Members of the FFIEC include the Board of Governors of the Federal Reserve System, the FDIC, the NCUA, the OCC, the CFPB, and the State Liaison Committee (SLC). The SLC includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors.

streams on cybersecurity to improve collaboration with law enforcement and intelligence agencies and to communicate the importance of cybersecurity awareness and best practices among the financial industry and regulators. Also, to foster consistency in the examination of state community banks, the Federal Reserve, the FDIC, and the FFIEC State Liaison Committee have adopted common examination procedures (referred to as the Examination Documentation (ED) modules) and have an ongoing, interagency process for the review and updating of the ED modules to reflect current regulatory and policy mandates. Moreover, all of the FFIEC member agencies collaborate on the development of common consumer compliance examination procedures to support consistent supervision related to consumer protection statutes and regulations.

Through the FFIEC, the agencies are considering ways to reduce burden associated with quarterly filing of the Consolidated Reports of Condition and Income (commonly called the Call Report), including collecting less data from banks. As part of this effort, agency staff are planning on-site visits to several community banks to better understand aspects of their Call Report preparation processes that could be sources of reporting burden. This would include having the banks show where manual intervention is necessary to report particular Call Report items. Also, agency staff have enhanced training on upcoming reporting changes, such as recently holding teleconferences to provide guidance on changes to regulatory capital reporting requirements.

Federal Reserve Efforts to Provide Regulatory Relief to Community Banks

The Federal Reserve has several internal efforts underway aimed at providing regulatory relief for community banks. For instance, the Federal Reserve periodically reviews its existing

supervisory guidance to assess whether the guidance is still relevant and effective. We recently completed a policy review of the supervision programs for community and regional banking organizations to make sure the programs and related supervisory guidance are appropriately aligned with current banking practices and risks.[8] The project entailed an assessment of all existing supervisory guidance that applies to community and regional banks to determine whether the guidance is still appropriate. As a result of this review, we are likely to eliminate some guidance that is no longer relevant and to update other guidance for appropriateness to current supervisory and banking industry practices and relevance to the risks to these institutions.

Additionally, we are continually working to calibrate examination expectations so that they are commensurate with the risks at these institutions. For example, the Federal Reserve has an initiative currently underway to use Call Report data and forward-looking risk analytics to identify high-risk community and regional banks, which would allow us to focus our supervisory response on the areas of highest risk and reduce the regulatory burden on low-risk community and regional banks.

Along these lines, the Federal Reserve adopted a new consumer compliance examination framework for community banks in January 2014.[9] While we have traditionally applied a risk-focused approach to consumer compliance examinations, the new program more explicitly bases examination intensity on the individual community bank's risk profile, weighed against the effectiveness of the bank's compliance controls. This should increase the efficiency of our

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[8] For supervisory purposes, the Federal Reserve uses the term "regional banking organization" to describe a state member bank and/or holding company with more than $10 billion, but less than $50 billion in total consolidated assets.

[9] See the Board's Consumer Affairs (CA) Letter 13-19 (November 18, 2013), "Community Bank Risk-Focused Consumer Compliance Supervision Program" at www.federalreserve.gov/bankinforeg/caletters/caltr1319.htm and CA Letter 13-20 (November 18, 2013), "Consumer Compliance and Community Reinvestment Act (CRA) Examination Frequency Policy" at www.federalreserve.gov/bankinforeg/caletters/caltr1320.htm.

supervision and reduce regulatory burden on many community banks. In addition, we revised our consumer compliance examination frequency policy to lengthen the time frame between on-site consumer compliance and Community Reinvestment Act examinations for many community banks with less than $1 billion in total consolidated assets.

We have also been investigating ways that would allow for more supervisory activities to be conducted off-site, which can improve efficiency and reduce burden on community banks. For example, we can conduct some aspects of the loan review process off-site for banks that maintain electronic loan records and have invested in technologies that would allow us to do so. While off-site loan review has benefits for both bankers and examiners, some bankers have expressed concerns that increasing off-site supervisory activities could potentially reduce the ability of banks to have face-to-face discussions with examiners regarding asset quality or risk-management issues. In that regard, we will continue to work with community banks that may prefer their loan reviews to be conducted on-site. In short, the Federal Reserve is trying to strike an appropriate balance of off-site and on-site supervisory activities to ensure that resources are used more efficiently while maintaining high-quality supervision of community banks.

The Federal Reserve has invested significant resources in developing various technological tools for examiners to improve the efficiency of both off-site and on-site supervisory activities, while ensuring the quality of supervision is not compromised. For instance, the Federal Reserve has automated various parts of the community bank examination process, including a set of tools used among all Reserve Banks to assist in the pre-examination planning and scoping. This automation can save examiners and bank management time, as a bank can submit requested pre-examination information electronically rather than mailing paper

copies to the Federal Reserve Bank. These tools also assist examiners in the off-site monitoring of community banks, enabling examiners to determine whether a particular community bank's financial condition has deteriorated and warrants supervisory attention between on-site examinations.

As we develop supervisory policies and examination practices, we are mindful of community bankers' concerns that new requirements for large banking organizations could become viewed as "best practices" that trickle down to community banks in a way that is inappropriate. To address this concern, the Federal Reserve is enhancing communications with and training for examinations staff about expectations for community banks versus large banking organizations to ensure that expectations are calibrated appropriately. Specifically, we are modernizing our longstanding examiner commissioning training program for community bank examiners, and a key part of this effort is ensuring that examiners are trained on the different supervisory programs and requirements for community banks and large banking organizations. In addition, when new supervisory policies are issued, we typically arrange a teleconference to explain the new policy to examiners, including whether and to what extent the policy is applicable to community banks. By effectively training our examination staff and providing channels to keep them informed of newly issued policies in a timely manner, examiners are better equipped to understand the supervisory goals of regulations and guidance for community banks and to provide appropriate guidance to community banks.

Small Bank Holding Company Policy Statement and Resulting Changes in Regulatory Reporting Requirements

More recently, the Federal Reserve Board has taken regulatory action to reduce the burden on community banking organizations with the issuance of a final rule that expands the

applicability of its Small Bank Holding Company Policy Statement and also applies the statement to certain savings and loan holding companies.[10] The policy statement facilitates the transfer of ownership of small community banks and savings associations by allowing their holding companies to operate with higher levels of debt than would normally be permitted. While holding companies that qualify for the policy statement are excluded from consolidated capital requirements, their depository institution subsidiaries continue to be subject to minimum capital requirements.

The final rule raises the asset threshold of the policy statement from $500 million to $1 billion in total consolidated assets. It also expands the application of the policy statement to savings and loan holding companies. All firms must still meet certain qualitative requirements, including those pertaining to nonbanking activities, off-balance sheet activities, and publicly registered debt and equity.

The scope of the previous policy statement has been expanded to cover approximately 440 additional bank holding companies and 280 savings and loan holding companies. Going forward, this means that 89 percent of all bank holding companies and 81 percent of all savings and loan holding companies will be covered under the policy statement. This expansion follows a revision to the Dodd-Frank Act recently passed by Congress.

In an action related to the expansion of the policy statement's scope, the Board took steps to relieve regulatory reporting burden for bank holding companies and savings and loan holding companies that have less than $1 billion in total consolidated assets and meet the qualitative

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[10] Board of Governors of the Federal Reserve System, "Federal Reserve Board Issues Final Rule to Expand Applicability of Small Bank Holding Company Policy Statement and Apply It to Certain Savings and Loan Holding Companies," press release, April 9, 2015, www.federalreserve.gov/newsevents/press/bcreg/20150409a.htm.

requirements of the policy statement. Specifically, the Board eliminated quarterly and more complex consolidated financial reporting requirements (FR Y-9C) for approximately 470 of these institutions, and instead required parent-only financial statements (FR Y-9SP) semiannually.[11] The Board also eliminated all regulatory capital data items that were to be reported on the FR Y-9SP for approximately 240 savings and loan holding companies with less than $500 million in total consolidated assets. The Board made these changes effective on March 31, 2015, and immediately notified the affected institutions, so they would not continue to invest in system changes to report revised regulatory capital data for only a short period of time.

Economic Growth and Regulatory Paperwork Reduction Act of 1996 Review

In addition to the Federal Reserve efforts mentioned earlier, the federal banking agencies and the FFIEC have launched a review to identify banking regulations that are outdated, unnecessary, or unduly burdensome, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA).[12] The major categories of regulations covered in the review include applications and reporting; powers and activities; international operations; banking operations; capital; the Community Reinvestment Act; consumer protection; directors, officers, and employees; money laundering; rules of procedure; safety and soundness; and securities. This review will cover all agency rules in these categories, including rules recently

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[11] The FR Y-9C consists of 65 pages of data items to be reported, whereas the FR Y-9SP consists of only 8 pages of data items.

[12] Board of Governors of the Federal Reserve System, FDIC, and OCC, "Federal Bank Regulatory Agencies Seek Comment on Interagency Effort to Reduce Regulatory Burden," press release, June 4, 2014, www.federalreserve.gov/newsevents/press/bcreg/20140604a.htm.

adopted or proposed in the implementation of the Dodd-Frank Act.[13] The agencies are soliciting comments on their regulations through notices in the *Federal Register*.

As part of the EGRPRA review process, the agencies are holding several outreach meetings with bankers, consumer groups, and other interested parties to engage individuals in a public discussion about the agencies' regulations. The agencies have conducted two outreach meetings to date in Los Angeles and Dallas, respectively. Additional outreach meetings are scheduled for the coming months, including Boston on May 4, 2015; Kansas City on August 4, 2015; Chicago on October 19, 2015; and Washington, D.C., on December 2, 2015. The Kansas City outreach meeting will focus more specifically on issues affecting rural institutions.[14]

Several themes have arisen so far from discussions at the outreach meetings. A recurring theme has been the question of whether the agencies could reevaluate the various thresholds and limits imposed in regulations that may constrain community banks and their lending activities. For example, community bankers in rural areas have noted that it can be difficult to find an appraiser with knowledge about the local market at a reasonable fee. Bankers have asked the agencies to consider increasing the dollar threshold in the appraisal regulations for transactions below which an appraisal would not be required, which could allow them to use a less-formal valuation of collateral for a larger number of loans.

Bankers have also asked whether the agencies could review the statutorily mandated safety-and-soundness examination frequency for banks, which varies based on a bank's asset

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[13] The review encompasses consumer regulations that were not transferred to the CFPB but remained with the banking agencies. For more information about the broader scope of the review, see: Board of Governors of the Federal Reserve System, FDIC, and OCC, "Agencies Announce Additional EGRPRA Outreach Meetings," press release, April 6, 2015, www.federalreserve.gov/newsevents/press/bcreg/20150406a.htm.

[14] See the FFIEC's EGRPRA website at http://egrpra.ffiec.gov/ for more information.

size and condition, as a way to ease burden from frequent on-site examinations. Other bankers have commented that some longstanding interagency guidance may now be outdated and warrant a fresh look and revision.

Some of the relief that bankers have asked for and suggestions developed through the EGRPRA process may require legislative action. We will work with the other federal banking agencies as appropriate to consider and assess the impact of potential changes identified through the EGRPRA review process.

Gathering the Views of Community Bankers

Outside of the EGRPRA review process, the Federal Reserve uses multiple channels to gather the views of community bankers on economic and banking topics, including regulatory burden. For instance, when a proposed rule or policy is issued to the public for comment, we gather information from banking organizations that assists us in assessing implementation complexity or cost, especially for the smallest institutions. The feedback received has been instrumental in helping us scale rules and policies to appropriately reflect the risks at these institutions without subjecting them to unnecessary burden. This was evident in the final capital rule that was issued in July 2013. The final rule reflected several changes to respond to comments and reduce the regulatory burden on community banks.

Also, in 2010, the Federal Reserve Board formed the Community Depository Institutions Advisory Council (CDIAC) to provide input to the Board of Governors on the economy, lending conditions, and other issues of interest to community depository institutions.[15] CDIAC members are selected from representatives of banks, thrift institutions, and credit unions serving on local

[15] http://federalreserve.gov/aboutthefed/cdiac.htm.

advisory councils at the 12 Federal Reserve Banks. One member of each of the Reserve Bank councils is selected to serve on the national CDIAC, which meets twice a year with the Board of Governors in Washington, D.C., to discuss topics of interest to community depository institutions.

In order to better understand and respond to concerns raised by these institutions through the various channels, the Federal Reserve Board has established a community and regional bank subcommittee of its Committee on Bank Supervision.[16] The governors on this subcommittee help the Board as a whole to weigh the costs associated with regulation against the safety-and-soundness benefits of new supervisory policies for smaller institutions. The subcommittee also meets with Federal Reserve staff to hear about key supervisory initiatives at community banks and ongoing research in the community banking area. Additionally, members of the Board of Governors routinely meet with representatives from banks of all sizes to discuss banking conditions and the regulatory landscape.

Conclusion

The Federal Reserve is committed to taking a balanced supervisory approach that fosters safe and sound community banks and fair treatment of consumers, and encourages the flow of credit to consumers and businesses. To achieve that goal, we will continue to work to make sure that regulations, policies, and supervisory activities are appropriately tailored to the level of risks at these institutions. In doing so, we will solicit and assess the views of bankers on supervisory issues and regulatory burden through the EGRPRA process and other communication channels.

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[16] http://federalreserve.gov/aboutthefed/bios/board/default.htm.

Thank you for inviting me to share the Federal Reserve's views on regulatory relief for community financial institutions. I would be pleased to answer any questions you may have.

Testimony of David Silberman
Associate Director of Research, Markets, and Regulations
Consumer Financial Protection Bureau
Before the House Financial Services Subcommittee
on Financial Institutions and Consumer Credit
April 23, 2015

Chairman Neugebauer, Ranking Member Clay, and Members of the Subcommittee, thank you for the opportunity to testify today about the Consumer Financial Protection Bureau's (Bureau) work to strengthen our financial system so that it better serves consumers, responsible businesses, and our economy as a whole. My name is David Silberman and I am the Associate Director for Research, Markets, and Regulations at the Consumer Financial Protection Bureau.

I joined the Bureau as part of the implementation team in December 2010. Prior to the Bureau, I served as General Counsel and Executive Vice President of Kessler Financial Services, a privately-held company focused on creating and supporting credit card and other financial services to membership organizations. My involvement in consumer financial services began when, as Deputy General Counsel of the AFL-CIO, I helped create an organization to provide financial services to union members and negotiated the first AFL-CIO credit card program. I began my career as a law clerk to Justice Thurgood Marshall.

As you know, the Consumer Bureau is the nation's first federal agency whose sole focus is protecting consumers in the financial marketplace. Products like mortgages and student loans involve some of the most important financial transactions in people's lives. Since we opened our doors, we have focused on making markets work better for consumers in America, and helping consumers improve their financial lives. Through fair rules based on research and quantitative analysis, consistent oversight, appropriate enforcement, and broad-based consumer engagement, the Bureau is working to restore consumer trust in the financial marketplace and to level the regulatory playing field for honest businesses. To date, our enforcement actions have helped secure approximately $5.3 billion in relief to millions of consumers victimized by violations of Federal consumer financial laws.

My role at the Bureau is to lead the Division of Research, Markets, and Regulations. The Division is responsible for articulating a research-driven, evidence-based perspective on consumer financial markets, consumer behavior, and regulations to inform the public discourse, inform Bureau thinking on priority areas, identify areas where Bureau intervention may improve market outcomes, and support efforts to reduce outdated, unnecessary, or unduly burdensome regulations. Where our research and analysis suggests the need for regulatory intervention, we seek to develop regulations which will protect consumers without unintended consequences or unnecessary costs. As part of the rulemaking process, we carefully assess the benefits and costs

of the regulations we are considering on consumers and financial institutions. Balanced regulations are essential for protecting consumers from harmful practices and ensuring that consumer financial markets function in a fair, transparent, and competitive manner.

As Director Cordray has said many times, the responsible lending that is the hallmark of community banks and credit unions did not cause the financial crisis. These institutions play a vital role in many communities and in our economy. Their traditional model of relationship lending has been beneficial for many people, especially in rural areas and small towns across this country. We are committed to ensuring that the Bureau incorporates the perspectives of small depository institutions into our policy-making process, communicates relevant policy initiatives to community banks and credit unions, and works with community banks and credit unions to identify potential areas for regulatory simplification. We reinforce our commitment to this model of responsible lending by meeting regularly with community bankers and credit union leaders in all 50 states. We also receive valuable insight and feedback from members of our Credit Union Advisory Council and Community Bank Advisory Council, which consist of more than 30 credit union and community bankers from every region.

As such, the Bureau is committed to ensuring our rules and regulations are tailored and balanced, so that as we fulfill our mandate to protect consumers, we are mindful of the impact of compliance on financial institutions and responsive to their concerns. We engage in rigorous evaluation of the effects of proposed and existing regulations on consumers and financial institutions throughout our rulemaking process, and maintain steady dialogue with consumer advocates and industry participants. To support the implementation of and industry compliance with its rules, the Bureau has published plain-language compliance guides and video presentations summarizing them, and it has actively engaged in discussions with industry about ways to achieve compliance.

Our ongoing efforts allow us to be responsive to concerns and make reasonable adjustments along the way. Congress also specifically mandated the agency to undertake a regulatory review process as part of our rulemaking authority. For example, under Section 1021 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the purpose of the Bureau is to implement and enforce Federal consumer financial laws consistently to ensure that all consumers have access to markets for consumer financial products and services, and that such markets are fair, transparent, and competitive. To more fully carry out this purpose, Section 1022 of the Dodd-Frank Act requires that within five years after the effective date of any significant rule or order adopted by the Bureau under Federal consumer financial law, the Bureau must assess the rule's effectiveness in meeting the purpose and objectives of Consumer Financial Protection Act and any other stated goals for a particular rule.[1] The Bureau is committed to this

[1] 12 U.S.C. § 5512(d).

review and, as required under the Act, will seek public comment and publish a report on its assessments as we complete each review.

Beginning in 2011, the Bureau demonstrated an early commitment to achieving effective regulations by issuing a Request for Information (RFI) to help identify priorities for streamlining inherited regulations. The Bureau identified a number of potential opportunities for streamlining, including simplifying regulations that have become unnecessarily difficult to understand and comply with over time; standardizing definitions of common terms across regulations where statutes permit; updating regulations that are outdated or unnecessary due to changing technologies; and removing unnecessary restrictions on consumer choice or business innovation.

Based upon comments received from stakeholders in response to this RFI, the Bureau identified a requirement that certain fee disclosures be posted on automated teller machines as a candidate for elimination. The Bureau provided technical assistance to Congress on the issue and Congress took action. The Bureau then issued a rule to implement the congressional directive.

The Bureau likewise targeted a provision of the regulations implementing the Credit Card Accountability Responsibility and Disclosure Act (the CARD Act), when we received feedback from some creditors that it precluded them from issuing credit cards to non-working, but otherwise creditworthy spouses. The Bureau amended that regulation to provide appropriate regulatory relief.

Additionally, the Bureau identified certain requirements regarding delivery of annual privacy notices under the Gramm-Leach-Bliley Act as potentially redundant. Then in October 2014, the Bureau finalized a rule to allow bank and nonbank financial institutions under certain conditions to post privacy notices online instead of distributing an annual paper copy. The approach we took considerably eases the financial burdens of such notices for many companies while still maintaining consumer disclosures. We estimate that choosing the new online disclosure method could save the industry about $17 million annually.

As you know, much of the Bureau's early work centered on the mortgage market, the primary cause of the financial crisis and thus where Congress saw reform as essential. As directed by Congress in the Dodd-Frank Act, the Bureau issued a series of mortgage rules, the majority of which took effect in January 2014, to address a variety of practices that contributed to the housing crisis and ensuing financial meltdown. Throughout the rulemaking process, the Bureau engaged with industry stakeholders and the public to ensure balanced rulemaking that would provide robust safeguards for consumers and clear guidance for financial institutions without imposing undue burdens.

In addition, the Bureau published exam guidelines months before the effective date of the mortgage rules to give institutions the time and confidence to prepare. We also distributed a readiness guide with a checklist of things to do before the rules took effect, such as updating policies and procedures and providing staff training. Bureau staff attended industry conferences and answered questions about implementing the mortgage rules. We also participated in webinars attended by thousands of participants.

The Bureau also maintains a regulatory implementation program, which connects industry representatives to regulatory experts to answer questions about the rules. As the Bureau became aware of critical operational or interpretive issues, we addressed them. In this vein, we adjusted and clarified the rules where needed, which included reopening the notice-and-comment process several times in limited areas. By addressing and clarifying industry questions, we reduced the need for individual institutions to spend time reaching their own uncertain judgments on these matters. And we recognized all along that if we could ease implementation without sacrificing any of our key objectives, the result would be better and more effective consumer financial protection.

As part of the Bureau's initial work mandated by Congress to reform the mortgage market, the Bureau developed a set of special provisions to provide "small creditors" – mostly community banks and credit unions – greater leeway to originate Qualified Mortgages (QMs). Among other things, these provisions provided a two-year transition period, during which balloon loans made by small creditors and held in portfolio can be treated as QMs, regardless of where the loans are originated and provided that after that period balloon loans originated by small creditors in rural or undeserved areas would be treated as QMs. We then committed to a thorough review of whether our definition of "rural or underserved" could be better calibrated to reflect significant differences in geographic areas, and facilitate access to credit for consumers.

We then undertook considerable analysis on the "rural or underserved" and also the "small creditor" definitions to prepare a proposed rule that would provide more room for residential mortgage lending by small creditors such as community banks and credit unions. The Bureau's proposal would expand the definition of "small creditor" by adjusting the origination limit to encourage more lending by these small local institutions. We also are proposing to expand the definition of "rural" areas to provide more access to credit in those areas. We accepted public comments on these issues through March 30, which we are now reviewing.

In a similar vein, in adopting our mortgage servicing rules, the Bureau created an exemption from most of the rules' requirements for "small servicers" which we defined so as to capture 98% of the community banks and credit unions who service mortgage loans. And, in the proposal we issued last year to implement the Dodd-Frank's expansion of data collection under the Home Mortgage Disclosure Act (HMDA), the Bureau proposed an exemption that we

estimate would reduce the number of community banks and credit unions obligated to submit HMDA reports by over 20%.

Under the Dodd-Frank Act, Congress directed the Bureau to combine the required mortgage disclosure forms for the Real Estate Settlement Procedures Act (RESPA) and Truth in Lending Act (TILA). After extensive consultation with the public, the Bureau developed new, easy-to-understand "Know Before You Owe" forms, which were finalized in November 2013. In response to concerns raised by stakeholders, the Bureau finalized minor amendments to the rule, designed to ease compliance, in January 2015.

As you may know, the Bureau has taken a number of steps to support industry implementation of the integrated disclosure rule and to help creditors, vendors, and others affected by the new rule understand, operationalize, and prepare to comply with the rule's new consumer protections. Since the integrated disclosure rule was first issued in November 2013, we have made it a point to engage directly and intensively with financial institutions and vendors through a formal regulatory implementation project, including focused efforts on the needs of smaller institutions. The Bureau's regulatory implementation program for the integrated disclosure rule includes the following:

Inter-agency coordination. The Bureau coordinates with other federal government regulators that also conduct examinations of mortgage companies to promote a consistent regulatory experience for industry. In-depth exam procedures were approved by the Federal Financial Institutions Examination Council on February 12, 2015 and ultimately published by the Bureau on April 1, 2015.

Publish "readiness guide," plain-language guides, and other resources. The "readiness guide" includes a detailed check-list of things for industry to do prior to the integrated disclosure rule effective date, such as updating policies and procedures and providing training for staff. The Bureau also published a compliance guide, a guide to the new integrated disclosure forms, and an illustrative timeline.[2] In addition, the Bureau has made the regulation easily navigable online through eRegulations.[3]

Publish an amendment to the integrated disclosure rule in response to industry requests. In January 2015, after extensive outreach to stakeholders, the Bureau adopted two minor modifications to the integrated disclosure rule in order to smooth compliance.[4]

Provide unofficial staff guidance. Bureau staff attorneys have provided oral guidance in response to over 600 regulatory interpretation inquiries relating to the integrated disclosure rule since it was issued.

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[2] www.consumerfinance.gov/regulatory-implementation/tila-respa/
[3] http://www.consumerfinance.gov/eregulations/1026-1/2014-25503_20150801#1026-1-a.
[4] 80 FR 8767 (February 19, 2015).

Engage with stakeholders. Bureau staff has provided remarks and addressed questions about the integrated disclosure rule and related implementation matters at over 40 formal events and over 50 informal stakeholder meetings since the integrated disclosure rule was issued in November 2013.

Conduct webinars. The Bureau has conducted a series of four free, publicly available webinars, available for viewing through the Bureau's website,[5] that provide guidance on how to interpret and apply specific provisions, including one conducted with the National Credit Union Administration specifically designed to address the concerns of credit unions. A fifth webinar is scheduled for May 26, 2015.

The Bureau's work supporting implementation of the integrated disclosure rule does not end with the effective date of the integrated disclosure rule. We expect to continue working with industry, consumers, and other stakeholders to answer questions, provide guidance, and evaluate any issues industry and consumers experience as the integrated disclosure rule is implemented.

A deep and thorough understanding of the consumer financial marketplace is essential to accomplish the Bureau's mission, and as such be evidence-driven. As the events leading up to the financial crisis illustrated, all regulators must have timely and accurate information about the markets they oversee. Information is essential to properly regulate markets, supervise market participants, protect consumers and honest businesses from unscrupulous activities, and ensure the stability of the financial system and of the economy generally.

While my work at the Bureau focuses on research, markets, and regulations, I want to mention that the Bureau's supervision program continues to be refined, improved, and matured as authorized under the Dodd-Frank Act. The Bureau supervises depository institutions and credit unions with total assets of more than $10 billion, and their affiliates. The Bureau also has authority under the Dodd-Frank Act to supervise nonbanks in specific markets. Bureau staff strive to conduct effective examinations while minimizing unnecessary burden on supervised entities. Examinations typically involve work done both off site and on site, scoped to focus on areas posing the highest potential risks to consumers. The Bureau has made it a priority to coordinate the timing and substance of examination activities with our federal and state regulatory partners.

When examinations reveal legal violations, we require appropriate corrective action, including financial restitution to consumers. We are also insistent that institutions have compliance management systems to prevent violations and ensure appropriate self-monitoring, correction, and remediation where violations have occurred. This work has strengthened compliance management at the large banks and caused many large nonbank firms to implement compliance management systems for the first time. Reinforcement of these expectations is helping to level the playing field for competitors across entire markets, regardless of charter or corporate form.

[5] http://www.consumerfinance.gov/regulatory-implementation/tila-respa/

Part of our statutory mandate is to address consumer financial issues in an even-handed manner across all market participants. We continue to build out our risk-based supervision program both for banks and for non-bank financial firms. This approach is enabling us to provide more consistent treatment that ensures compliance with Federal consumer financial laws and helps level the playing field among competing firms in mortgage origination, mortgage servicing, debt collection, student loan servicing, and other markets.

The premise at the heart of our mission is that consumers deserve to be treated fairly in the financial marketplace, and they should have someone stand on their side when that does not happen. So far, our Office of Consumer Response has received more than 590,000 consumer complaints about mortgages, credit cards, student loans, auto loans, credit reporting, debt collection, and many other consumer financial products or services, which has resulted in relief for many consumers.

The progress we have made has been possible thanks to the engagement of hundreds of thousands of Americans who have utilized our consumer education tools, submitted complaints, participated in rulemakings, and told us their stories through our website and at numerous public meetings from coast to coast. We have also benefited from an ongoing dialogue and constructive engagement with the institutions we supervise, with community banks and credit unions with whom we regularly meet, and with consumer advocates throughout the country.

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

Questions for Mr. Toney Bland, Senior Deputy Comptroller, Midsize and Community Bank Supervision, Office of the Comptroller of the Currency

Rep. Ruben Hinojosa

1. Former Chairman of the Federal Reserve recently came out with a proposal that called for a sweeping re-organization of federal financial regulators, and which called for creating one prudential banking regulator that would regulate and supervise banks rather than having those duties split between your three agencies – the FDIC, OCC and the FRB.

a. Will consolidation of our bank regulators into one agency simplify and ease the regulatory burden faced by community banks? Why or why not?

Response: The OCC is the primary regulator of both national banks and federal savings associations. Unlike state-chartered banks that are subject to supervision by examiners from the chartering state and either the FDIC (for state non-member banks) or the FRB (for state member banks), the OCC is the sole prudential supervisor for nationally-chartered banks and federal savings associations. At the OCC, we tailor our supervision to the activities and risk profile of each institution, and we continually seek opportunities to reduce regulatory burden on the community banks we regulate. We do not believe efforts to consolidate the bank regulators into one agency will result in additional simplifications or reductions in the regulatory burden faced by nationally-chartered community banks.

2. From experience, what is the number one regulatory burden complaint your agencies see from community banks?

Response: In our interactions with community bankers, the regulatory burden complaint that we hear most frequently is the layering of new regulations and requirements on top of the requirements already in place. We also continually hear that the cost to ensure appropriate, updated compliance programs and talent is sizable.

We recognize that these are pressing concerns for community banks, and that community banks have different business models and more limited resources than larger banks. Where we have flexibility under the law, we seek to tailor our supervision to a bank's size and complexity and factor these differences into the rules we write and the guidance we issue.

We have tailored our rules in several instances to accommodate community banker regulatory burden concerns. For example, in revising the regulatory minimum capital rules we limited the application of the supplementary leverage ratio and countercyclical capital buffer to the largest banking organizations that engage in complex or risky activities. In addition, to address concerns voiced by community bankers, we helped to ensure retention of the capital treatment for residential mortgage exposures and to allow community banks to elect to continue the treatment of certain accumulated other comprehensive income in the final rule. We excluded community banks from our liquidity coverage rule, as they do not need the structured, explicit standards for liquid assets required for the largest banks. Also, the agencies' risk retention rule

allows all qualifying mortgages under the Consumer Financial Protection Bureau's mortgage rules to qualify as qualified residential mortgages, minimizing the rule's impact on community banks engaged in securitization activities. We revised the lending limit rule and addressed community banker concerns by exempting certain securities financing transactions commonly used by community banks from the lending limit calculation. In the revision, we also provided small banks with flexible options for measuring covered counterparty credit exposure and included an easy-to-use lookup table.

We constantly strive to provide useful tools and resources to reduce burden and assist community bankers in managing their risks. We offer webinars and have designed bulletins that announce new regulations or supervisory guidance, allowing community bankers to readily determine if and how the new regulation or guidance applies to them. We also produced a streamlined summary of the final domestic capital rule and supplemented it with an online regulatory capital estimator tool, developed with the other federal banking agencies. Other useful tools we have provided banks to manage risk through our secure BankNet Web site include a commercial real estate portfolio-level stress test tool, as well as a tool that allows bankers to develop a customized peer report they can use to compare their bank's balance sheet and financial performance ratios to those of other banks. Finally, we issue a *Semiannual Risk Perspective* document that provides bankers with an analysis of current market and risk trends that may affect their institutions.

3. In your opinion, what is the most important or significant action Congress can take to ease the regulatory burden on our community banks? In your answer, please outline specific proposals.

Response: The OCC has put forth several legislative proposals we believe would help ease community bank regulatory burden. These include:

- Amendments to the scope of the Volcker Rule. The OCC has proposed to exempt depository institutions with total consolidated assets of $10 billion or less (community banks) from the Volcker Rule. The risks to the financial system of proprietary trading or owning or sponsoring equity and hedge funds are far more significant when larger institutions engage in these activities than when community banks do so, to the extent they do so at all. The regulatory burden of requiring community banks to ascertain whether their activities are covered by the Volcker Rule, in order to understand if they have any compliance obligations, is not justified by the risk these institutions present. If an exempt community bank were to engage in any of the activities covered by the Volcker Rule, the federal banking agencies could address any concerns as part of their normal safety and soundness supervisory processes. In the alternative, Congress could reserve the authority of each federal banking agency to apply the Volcker Rule to an exempt community bank if the agency determines that the bank's activities are inconsistent with traditional banking activities or, due to their nature or volume, the activities pose a risk to the safety and soundness of the bank.

We estimate this amendment could initially exempt more than 6,000 community banks from the requirement to comply with the regulations implementing the Volcker Rule.

- Revisions to the Examination Schedule. The OCC has submitted a proposal to increase the $500 million asset-size threshold that determines whether a community bank can qualify for an examination every 18 months, rather than every 12 months. This increased threshold would apply, as it does today, only to healthy, well-managed banks. The OCC would continue to use off-site monitoring tools in the interim to identify potential problems in a qualifying institution, and if warranted could examine the institution more frequently. We estimate this amendment would reduce burden for more than 400 banks.

- Changes to Permissible Activities for Federal Savings Associations. The OCC has offered legislation that would give a federal savings association a choice to continue to operate as a traditional thrift or opt to expand its business model to include powers available to national banks. Thrifts that choose this treatment would have the powers of and be subject to the same restrictions as a national bank, and subject to the rules governing non-conforming assets and subsidiaries. This option provides a federal savings association with the flexibility to retain its current corporate form and governance structure without unnecessarily limiting the evolution of its business plan.

4. To the extent that you testified that bright-line asset thresholds are not helpful in conducting effective, yet not overly burdensome regulatory oversight, of community banks, which asset thresholds in particular hamper your agency's oversight responsibilities and/or create undue regulatory burdens on community banks?

a. To the extent your answer outlined any particular statutory or other asset threshold, what alternative to said asset threshold does your agency recommend?

Response: The OCC's approach to community bank supervision is not bound by asset thresholds. The OCC employs a risk-based approach to supervising community banks. As noted in my testimony, portfolio managers tailor the supervision of each community bank to its individual risk profile, business model, and management strategies.

Rep. Blaine Luetkemeyer

1. As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

2. Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

Response: The OCC takes seriously the need to understand how its rules affect the public and private sectors and the economy as a whole. As part of this effort, the OCC conducts several types of economic impact assessments for all proposed and final rules, including those provided for by the following statutes:

- Unfunded Mandates Reform Act: The OCC assesses whether a proposed or final rule includes a "federal mandate" that may result in the expenditure by state, local, or tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year (adjusted for inflation). If this threshold is met, the OCC prepares a more detailed economic assessment of the rule's anticipated costs and benefits.
- Congressional Review Act: The OCC determines, among other things, whether a final rule is likely to result in a $100 million or more annual effect on the economy.
- Regulatory Flexibility Act: The OCC determines if a proposed or final rule is likely to have a "significant economic impact on a substantial number of small entities."
- Paperwork Reduction Act: The OCC assesses the anticipated cost of any "collection of information" associated with its regulatory provisions.
- Riegle Community Development and Regulatory Improvement Act of 1994: The OCC considers burdens and benefits when establishing effective dates and determining compliance obligations associated with its rules.
- Administrative Procedure Act: The OCC solicits comments on the regulatory burden associated with its proposals, encourages feedback on how burden could be reduced, and carefully considers all comments received in formulating its final rules.

In addition, as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996, the OCC, Federal Deposit Insurance Corporation and Board of Governors of the Federal Reserve System are currently conducting a decennial review of its regulations. The purpose of this review is to identify outdated, unnecessary, or unduly burdensome regulations and consider how to reduce regulatory burden on insured depository institutions. Among other things, this review provides the public with an opportunity to identify the costs and burdens of particular regulations or combinations of regulations.

The OCC's Guide to OCC Rulemaking Procedures (Guide) contains a detailed and comprehensive description of its entire rulemaking process, describes the various steps the OCC takes at each point in the rulemaking process, and seeks to ensure that the OCC complies with rulemaking requirements imposed by relevant statutes. The Guide also promotes the integrity of the OCC's rulemaking process by ensuring accountability and appropriate documentation of decision-making. Please let us know if you would like a copy of the Guide.

Rep. Juan Vargas

Questions Regarding Bank Closures on the California-Mexico Border to be directed to Office of the Comptroller of the Currency's Witness Toney Bland, National Credit Union Administration's Witness Larry Fazio, and Federal Deposit Insurance Corporation's Witness Doreen Eberley

I represent the entire U.S-Mexico border in California. As you well know, border economies raise unique challenges for financial institutions. Sadly, my district has one of the highest incidences of sex trafficking in the country. I know the work you and other regulators do is crucial in preventing those criminal enterprises, as well as drug and labor traffickers, from accessing our financial system. I know that your work, indirectly, protects my constituents and their families. I sincerely thank you for that.

At the same time, it is important to make sure that honest, hardworking people have access to credit and banking services, especially in underserved communities. My district has seen four bank branches close in the last year and another three branches plan to close, leaving whole swaths of the area with only a single financial institution. I understand that this issue is affecting not only my district, but Arizona and Texas as well.

With that in mind, can you speak to any proposals or policies that we can put in place that would prevent further branch closures along the southwest border and potentially incentivize banks and credit unions to open more branches in those regions?

Response: The OCC is the primary regulator of both national banks and federal thrifts (banks). Twelve U.S.C. § 1831r-1 governs branch closings by insured depository institutions, including the banks that have closed branches in your district. In general, before an OCC-regulated institution or a bank can close a branch, it must timely deliver notice of its intent to do so to the OCC or its federal regulator and to the branch's customers, and further, it must timely post notice in the branch itself. If the bank complies with these requirements, § 1831r-1 does not give the OCC any authority to prevent it from closing that branch.

The statute provides for a slightly different procedure if an interstate bank (as defined in § 1831r-1(d)(4)) seeks to close a branch that is located in a low- or moderate-income community. In addition to the general requirements set forth above, the notice posted at the branch must inform persons in that area that they may send comments about the proposed closing to the OCC. If the comments received by the OCC meet certain criteria, then the statute requires the agency to engage in consultations and meetings to explore the feasibility of obtaining adequate alternative facilities and services for the area served by the branch. However, under § 1831r-1(d)(3) the OCC may not take any action that would affect the closing of the branch. In short, the decision to close a branch is a business decision and that decision is reserved to the bank.

Although the OCC cannot take any action that would affect the closing of a branch, the OCC does evaluate the availability and effectiveness of a bank's systems for delivering retail banking services under the Community Reinvestment Act regulations. Among other factors, examiners evaluate (i) the current distribution of the bank's branches among low-, moderate-, middle- and upper-income census tracts and (ii) in the context of its current distribution of the bank's branches, the bank's record of opening and closing branches, particularly branches located in low- or moderate-income census tracts or primarily serving low- or moderate-income individuals. However, the Community Reinvestment Act and the related regulations do not require a bank to provide services that are inconsistent with safe and sound operations. To the contrary, the federal banking regulators anticipate that banks can meet these standards with safe and sound services. To that end, the OCC also evaluates the availability and effectiveness of alternative systems for delivering retail banking services in low- and moderate-income census tracts and to low- and moderate-income individuals. Some banks have provided alternative delivery systems, e.g., ATMs, mobile banking, internet banking, loan production offices, etc., to their customers in areas where maintaining unprofitable full-service branches may raise safety and soundness concerns.

The OCC appreciates your support of federal efforts to combat terrorism as well as drug and sex trafficking through the enforcement of the Bank Secrecy Act (BSA) and anti-money laundering (AML) laws. We understand your concern regarding negative externalities that may be associated with the enforcement of those statutes and requests for consideration of such consequences. As a general matter, the OCC does not direct banks to open, close, or maintain individual accounts, nor does the agency encourage banks to engage in the termination of entire categories of customer accounts without regard to the risks presented by an individual customer or the bank's ability to manage the risk. However, we do require that banks comply with BSA and AML requirements and establish programs, processes and controls appropriate to the risk of their customers.

The OCC has agreed to participate with the FDIC in educational workshops with banks that serve cross-border customers, with a particular focus on best practices in establishing and administering systems to comply with BSA and AML requirements.

DRAFT Answers

Questions for the Record from
Rep. Blaine Luetkemeyer (MO-03)
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
U.S. House of Representatives

Hearing held on April 23, 2015
"Examining Regulatory Burdens – Regulator Perspective"

To all witnesses:

1. As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

   As a state regulator, my agency is not subject to the cost-benefit analysis requirements of the Riegle Community Development Act of 1994. However, I think it is important for any regulator to evaluate the costs and benefits of regulations. My agency is subject to similar requirements under state law. Texas Government Code §2001.24(a)(4) and (5) and §2006.002 requires all agencies, including the Texas Department of Banking, to conduct a cost benefit analysis of proposed rules. The Texas Department of Banking has complied with this requirement on its proposed rules which would include those proposed pursuant to the Dodd-Frank Act.

2. Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

   Yes, under Texas Government Code §2001.24(a)(4) and (5) and §2006.002, the Texas Department of Banking is required to conduct a cost benefit analysis of proposed rules. The Texas Department of Banking has complied with this requirement on its proposed rules which would include those proposed pursuant to the Dodd-Frank Act.

**Response to questions from the Honorable Ruben Hinojosa
by Doreen Eberley, Director, Division of Risk Management Supervision,
Federal Deposit Insurance Corporation**

Q1: As noted in your testimony, the FDIC currently provides well-run and well-rated banks with assets of less than $500 million relief by extending the examination cycle from the standard 12 month cycle to 18 months. The OCC has drafted a legislative proposal that would raise the qualification threshold from $500 million to $750 million, and the FRB has reduced examination frequency for banks under $1 billion in assets. Does the FDIC support these threshold increases and does the FDIC plan to follow suit, why or why not?

A1: The FDIC is open to the proposed increase in the asset threshold for institutions eligible for the 18 month safety-and-soundness examination cycle from $500 million to $750 million, as contained in the OCC's legislative proposal.

With regard to the Federal Reserve, its consumer protection examination cycle policies provide for a 36 month examination cycle for well-rated institutions *above* $350 million and a 12-month cycle for all poorly-rated institutions. The Federal Reserve also has adopted an extended consumer protection cycle for well-rated institutions with *less* than $350 million in total assets that provides for examinations every 48 months or 60 months depending upon the institution's Community Reinvestment Act rating. Although the FDIC's consumer protection examination cycle is the same for institutions with assets above $350 million, the FDIC would have concerns about our ability to appropriately carry out our consumer protection supervisory obligations if we adopted the Federal Reserve's expanded examination cycle for well-rated institutions with total assets less than $350 million.

Q2: On April 18, 2015, the New York Times came out with an article entitled "Regulator Relief for Banks that Rarely Fail," which in large parts provides a discussion of a proposal by Thomas H. Hoeing, Vice Chairman of the FDIC, that would provide regulatory relief to low-risk, traditional banks.

Q2a: Is this proposal finalized? If so, is the FDIC going to make this proposal available to the Financial Services Committee? If not, when does the FDIC expect the proposal will be finalized?

A2a: Vice Chairman Thomas H. Hoenig is an independent member of the FDIC's Board of Directors who draws upon his significant regulatory experience when considering a variety of issues confronting the financial industry. Vice Chairman Hoenig's proposal is publicly available to the Financial Services Committee at https://www.fdic.gov/news/news/speeches/spapril1515.html. Vice Chairman Hoenig has not presented his proposal to the FDIC Board or staff for formal consideration.

Q2a(i): Is this proposal the official position of the FDIC?

A2a(i): As noted in Vice Chairman Hoenig's speech, the views expressed are those of the author and do not necessarily represent the views of the FDIC. That being said, we remain open to discussion of proposals to simplify regulations in a way that does not sacrifice important safety and soundness objectives.

Q2b: To what extent does this proposal require legislative action, and to what extent can the FDIC carry out the regulatory relief in the proposal through its discretionary powers under the current codified framework?

A2b: FDIC Vice Chairman Hoenig's proposals for regulatory relief (described in remarks presented to the 24th Annual Hyman P. Minsky Conference at the National Press Club in Washington, D.C., on April 15, 2015, and referred to in the New York Times article entitled "Regulatory Relief for Banks That Rarely Fail") include:

1. Exempting traditional banks from all Basel capital standards and associated capital amount calculations and risk-weighted asset calculations.

2. Exempting such banks from several entire schedules on the Call Report, including schedules related to trading assets and liabilities, regulatory capital requirement calculations, and derivatives.

3. Allowing for examiner judgment and eliminating requirements to refer "all possible or apparent fair lending violations to Justice" if judged to be de-minimis or inadvertent.

4. Establishing criteria that would exempt traditional banks from appraisal requirements.

5. Exempting traditional banks, if applicable, from stress testing requirements under section 165(i)(2) of the Dodd-Frank Act.

6. Where judged appropriate, allowing for an 18-month examination cycle as opposed to the currently required 12-month cycle for traditional banks.

The extent to which the proposals would require legislative action and the extent to which the FDIC could carry out the regulatory relief through its discretionary authority would vary and would depend on further details. For example, legislative action would be required to provide for a change to the annual on-site safety and soundness examination cycle. Section 10(d) of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1820(d), provides that the required 12-month interval for annual examinations may be extended to an 18-month interval for small institutions with less than $500 million total assets, provided that certain conditions are met. Because Congress expressly provided for a 12-month examination cycle (with limited exceptions for certain banks up to $500 million in assets) in section 10(d) of the FDI Act, legislative action would be needed to expand this to larger banks.

As another example, Section 165(i)(2) of the Dodd-Frank Act requires the federal banking agencies to issue regulations requiring financial companies with more than $10 billion in total consolidated assets to conduct annual stress tests. The statutory language governing stress testing is more detailed and prescriptive than the language covering other prudential standards, leaving the regulators with less discretion to tailor the stress testing process. Legislative action would be needed to provide additional discretion for the federal banking agencies in applying these statutory standards.

Questions directed at:

- **Ms. Doreen Eberley (Director, Division of Risk Management Supervision, FDIC);**
- **Mr. Toney Bland (Senior Deputy Comptroller, OCC);**
- **Ms. Maryann Hunter (Deputy Director, Division of Banking Supervision and Regulation, FRB).**

Q3: Former Chairman of the Federal Reserve recently came out with a proposal that called for a sweeping re-organization of federal financial regulators, and which called for creating one prudential banking regulator that would regulate and supervise banks rather than having those duties split between your three agencies – the FDIC, OCC and the FRB.

Q3a: Will consolidation of our bank regulators into one agency simplify and ease the regulatory burden faced by community banks? Why or why not?

A3a: Consolidating bank regulators into one agency may not necessarily ease regulatory burden faced by community banks. For example, at present, community banks have one primary federal regulator that promulgates rules, guidance, and policies, and examines banks for safety and soundness and compliance with consumer protection laws and with the Community Reinvestment Act (CRA). Under the proposal you mentioned from former Federal Reserve Chairman Paul Volcker, community banks would have one agency that promulgates prudential rules and standards and another that supervises the bank for safety and soundness. It is not clear which agency would conduct consumer compliance or CRA examinations under the proposal.

Moreover, while the proposal indicates the one supervisory agency would have a special division for the supervision of community banks, it is possible that the needs of community banks could receive less attention because the single regulator's resources could primarily be devoted to the largest banks. Also, it is not clear how state supervisors would interact with this new agency. As the primary federal regulator for state nonmember banks, the FDIC works closely with state supervisors in overseeing the more than 4,000 banks we directly supervise, most of which are community banks.

Q4: From experience, what is the number one regulatory burden complaint your agencies see from community banks?

A4: In our conversations with community bankers, the most common regulatory burden complaint is the cumulative effects of laws and regulations over time, rather than one specific law, rule, or regulation that has the most impact on the operations of community banks. That said, community

bankers have expressed concern with the Bank Secrecy Act, the mortgage rules promulgated by the Consumer Financial Protection Board, and the capital rules.

Q5: In your opinion, what is the most important or significant action Congress can take to ease the regulatory burden on our community banks? In your answer, please outline specific proposals.

A5: The Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, and the Federal Financial Institutions Examination Council (the Agencies) are engaged in a process pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) to identify and address outdated, unnecessary, or duplicative regulations. At the conclusion of this process, the Agencies will present a report to Congress describing the results of this effort. The report will outline steps the Agencies will take to address the concerns identified through the EGRPRA process. It also will include specific legislative recommendations where needed.

However, it should be noted that a number of comments received to date during the EGRPRA process have centered around changing laws related to long-standing thresholds, for example, dollar thresholds for extending the examination cycle from 12 to 18 months, for transactions requiring a real estate appraisal, and for transactions requiring a currency transaction report. Also, elimination or reduction of requirements for banks to send privacy notices to consumers has been a recurring theme. As discussed above, several of these changes would require statutory changes.

Q6: To the extent that you testified that bright-line asset thresholds are not helpful in conducting effective, yet not overly burdensome regulatory oversight, of community banks, which asset thresholds in particular hamper your agency's oversight responsibilities and/or create undue regulatory burdens on community banks?

A6: We have not identified particular bright-line asset thresholds that hamper the FDIC's oversight responsibilities of community banks. We use a risk-focused and tailored supervisory approach that considers the size, complexity, and risk profile of the community banks we supervise.

With respect to larger institutions, we have similarly not identified bright line asset thresholds that hamper the FDIC's oversight. However, we have identified at least one instance where the specificity of the statutory language limits the supervisory flexibility of the federal banking agencies. In this case, we would be open to more flexibility for our supervisory approach to stress tests, although this would not require a change in the threshold for conducting stress tests, but rather a change in the statutory requirements triggered by the threshold. This would allow us to recognize the differences in risk profiles among larger institutions, much as we are able to do with smaller institutions.

As discussed above, a number of comments received to date during the EGRPRA process, primarily from community bankers during our outreach sessions, have centered on changing laws related to long-standing thresholds, for example, dollar thresholds for extending the examination cycle from 12 to 18 months, for transactions requiring a real estate appraisal, and for transactions requiring a currency transaction report.

Q6a. To the extent your answer outlined any particular statutory or other asset threshold, what alternative to said asset threshold does your agency recommend?

A6a: Not applicable.

Response to questions from the Honorable Blaine Luetkemeyer by Doreen Eberley, Director, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

To all witnesses:

Q1: As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

A1: The FDIC adheres to the requirements of the Riegle Community Development and Regulatory Improvement Act (Riegle Act) in all of its applicable rulemakings.

Section 302(a) of the Riegle Act generally requires that, when determining the effective dates and administrative compliance requirements of new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, the FDIC consider any administrative burdens that the regulations would place on depository institutions, including small depository institutions and bank customers, and the benefits of such regulations.

The FDIC considers the administrative burdens on regulated entities and the public, as well as the benefits of regulations, particularly when setting effective dates and making "good cause" determinations in relation to expedited rulemaking effective dates as required by Section 302(b) of the Riegle Act.

Q2: Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

A2: The FDIC has conducted economic analyses for Dodd-Frank rulemakings.

The FDIC evaluates benefits and costs for all of its rulemakings based on available information and considers reasonable and possible alternatives. The FDIC strives to conduct a rulemaking process that not only satisfies our statutory obligations but also is transparent, well-informed, and analytically well-supported. The FDIC's longstanding policy is to minimize to the extent practicable the burdens that the rules it adopts impose on the banking industry and the public.

The FDIC's published Statement of Policy on rulemaking sets forth basic principles governing the development and review of regulations and policies. These principles reflect a multi-step process aimed at ensuring that its regulations achieve legislative or other policy goals effectively and efficiently, while minimizing regulatory burdens on the public and the banking industry. This is in addition to any statutory analysis requirements, such as under the Regulatory Flexibility Act.

For all its rulemakings, the FDIC:

- Carefully considers the need for any regulatory action;

- Evaluates benefits and costs, based on available information, and considers reasonable and possible alternatives;

- Describes the main alternatives in any notice of proposed rulemaking and typically requests comment on their pros and cons, including costs and benefits and effect on competition, and solicits additional ideas for alternatives;

- Pays particular attention to the impact a regulation would have on small institutions and whether there are alternatives that would accomplish our goals and minimize burden on small institutions;

- Carefully reviews the comments received, weighing the costs and benefits as we develop a final rule; and

- Discusses our response to the comments and our thinking on these matters in the preamble to the final rule.

The FDIC does not rely on any single approach in evaluating the costs and benefits associated with its rulemakings. Rather than applying a one-size-fits-all methodology to its economic analysis, the FDIC tailors its approach to each rule, using the most appropriate analytical tools to determine the likely costs and benefits of the rule, and is particularly sensitive to the effect its rules may have on the resources of community banks.

Additional Background: In 2011, an Inspector General's report evaluated the FDIC's economic analysis of three rulemakings to implement provisions of the Dodd-Frank Act. The Inspector General's findings confirmed that, for all three rules, FDIC staff followed statutory and FDIC requirements related to rulemaking and economic analysis; worked with other financial regulatory agencies to ensure a coordinated rulemaking effort; performed quantitative analysis of relevant data; considered alternative approaches to the rules; and, where applicable, included information about the analysis that was conducted and assumptions that were used. The report also found that each of the proposed rules was considered by the FDIC Board of Directors in open, public meetings. See FDIC's Office of Inspector General, Evaluations Report No. EVAL-11-003, June 2011.

Response to questions from the Honorable Juan Vargas
by Doreen Eberley, Director, Division of Risk Management Supervision,
Federal Deposit Insurance Corporation

Questions Regarding Bank Closures on the California Mexico Border to be directed to Office of the Comptroller of the Currency's Witness Toney Bland, National Credit Union Administration's Witness Larry Fazio, and Federal Deposit Insurance Corporation's witness Doreen Eberley.

I represent the entire U.S-Mexico border in California. As you well know, border economies raise unique challenges for financial institutions. Sadly, my district has one of the highest incidences of sex trafficking in the country. I know the work you and other regulators do is crucial in preventing those criminal enterprises, as well as drug and labor traffickers, from accessing our financial system. I know that your work, indirectly, protects my constituents and their families. I sincerely thank you for that.

At the same time, it is important to make sure that honest, hardworking people have access to credit and banking services, especially in underserved communities. My district has seen four bank branches close in the last year and another three branches plan to close, leaving whole swaths of the area with only a single financial institution. I understand that this issue is affecting not only my district, but Arizona and Texas as well.

Q1: With that in mind, can you speak to any proposals or policies that we can put in place that would prevent further branch closures along the southwest border and potentially incentivize banks and credit unions to open more branches in those regions?

A1: The FDIC recognizes the importance of the services insured financial institutions provide to their communities and is aware that some banks have closed branches in certain border areas. However, each financial institution decides whether it will offer services or operate in a particular location.

We also are aware that the Financial Crimes Enforcement Network (FinCEN) issues geographical targeting orders (Orders) that impose additional reporting and recordkeeping obligations on specific trades and businesses in certain locations, including border areas. FinCEN uses the Orders to enhance law enforcement's efforts to identify and prosecute money launderers who service criminal organizations. It is possible that these Orders may have some influence on banks' decisions to provide services in certain geographic areas.

To the extent that banks may make these branching decisions based on misperceptions related to regulatory expectations, the FDIC has taken steps to encourage financial institutions to serve their communities. In January 2015, the FDIC issued a *Statement on Providing Banking Services* (FIL-5-2015) that encourages institutions to take a risk-based approach in assessing individual consumer relationships rather than declining to provide banking services to entire categories of customers without regard to the risks presented by an individual customer on the bank's ability to manage the risk.

Offering legislative or regulatory incentives for institutions to open more branches or to prevent branch closures in border areas may raise legal issues, particularly if the branches are not economically viable. However, the FDIC and the other federal financial institution regulatory agencies have issued guidance related to branch closings. The applicable guidance addresses statutory requirements for insured financial institutions to submit a notice of any proposed branch closing to the primary federal regulator. The required notice must include a detailed statement of the reasons for the decision to close the branch and statistical or other information in support of such reasons. In certain cases, persons from the affected area may submit a written request relating to the proposed branch closing.

Response to question at the hearing from the Honorable Robert Pittenger by Doreen Eberley, Director, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1: Ms. Eberley, I have had a number of comments from smaller banks in my region and I would just like to read you one very, very quickly. Here is one bank, less than $50 million in assets and 10 employees. They come in, they want 3 to 4 weeks advance to tell us the materials to forward to them. When we get started, they are on-site. The daily work that they put in is eight to 10 examiners are there. They take 2 to 3 weeks. These are institutions will less than $50 million. They said, you know, if any corrections are to be done, it takes several weeks and months to do this. And they said, you know, we are spending a larger and larger amount of our time on compliance. We can't reach -- meet the needs of our customers. Is that a concern for you?

A1: As the primary federal regulator for the majority of smaller, community institutions, the FDIC is keenly aware of the challenges facing community banks, including their limited resources, and already tailors the supervisory approach to consider the size, complexity, and risk profile of the institutions it oversees. In 2013, in response to concerns about pre- and post-examination processes, the FDIC developed a web-based tool that generates a pre-examination document and information request list that is tailored to a specific institution's business model and overall operations. Tailored pre-examination planning enables us to review documents ahead of the examination, so we can spend less time on-site. We send this list in advance of the examination based on feedback from bankers who have said they prefer to have as much advance notice as possible to prepare the documentation.

On average, for well-rated banks with assets of $50 million or less, 6 examiners are onsite at the bank for 8 to 9 days.[1] Additional work, including review of the materials requested in advance of the examination, is completed off-site. On average, for well-rated banks with assets of $50 million or less, the entire examination lasts 25 days. The FDIC strives to conduct examinations as efficiently as possible and to spend as little time on-site as necessary while performing the work needed to confirm the information it received off-site

[1] These are only averages and time frames do vary depending on a number of factors, including the bank's condition and risk profile, availability of management, holiday delays or weather issues.

Response to question at the hearing from the Honorable Robert Heck by Doreen Eberley, Director, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1: I have another quick question, probably don't have time for it. We have tried very hard to provide carve-outs or exemptions to smaller institutions, in recognition that some of these things might not, again, best suit the purpose of the smaller institutions. What we are hearing, however, is that there is evolving a pressure toward best practices which come from, "above the larger standards, rules, and regulations." It is hard for me to ferret out exactly the origin of this. Is it the -- this is not for you, Mr. Silberman, I apologize; this is for Ms. Eberley and Mr. Fazio. Is this pressure, in your opinion, coming from examiners, from the consultants? I would like a brief -- because I have limited time -- sense of do you think that there is this kind of amorphous pressure that even though we grant carve-outs, for which we think are very valid reasons, nonetheless kind of the cultural milieu and context mitigates against the very thing we are trying to accomplish in that regard?

A1: We have heard about a "trickle down" effect where community bankers feel that there is pressure to comply with rules and guidance intended for larger banks. Frankly, in our observations, we have seen consultants marketing services, models, and other tools to community banks that are more suited to a large bank. In fact, to address some of these concerns, we published an article that points out that by making use of available resources provided by the FDIC and maintaining open communication with the FDIC to clarify regulatory expectations, community banks may be able to avoid potentially unnecessary consultant fees.

As a general rule, FDIC examinations adhere to statutory and regulatory thresholds and do not impose guidance or regulations that are not applicable to an organization. Our communications to examiners and bankers on supervisory matters clearly identify to whom the guidance or regulations apply. Additionally, we continually encourage bankers to contact our regional offices to discuss any questions they may have regarding our regulations and guidance, including issues of applicability.

House Financial Services Committee Subcommittee on Financial Institutions
Hearing on Examining Regulatory Burdens—Regulator Perspectives
April 23, 2015

Questions for Larry Fazio, Director of the Office of Examination and Insurance, NCUA, from Congressman Blaine Luetkemeyer

As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

Section 302 of the Riegle Act requires each "federal banking agency" to consider any administrative burdens of new regulations, as well as the benefits.[1] Any consideration must be consistent with the principles of safety and soundness and the public interest. The definition of a federal banking agency, as it applies to this part of the statute, does not include NCUA.

While Section 302 of the Riegle Act does not apply to NCUA, NCUA strives to ensure the agency's rulemakings are reasonable and cost-effective. NCUA additionally conducts analysis to ensure regulatory choices are made after appropriate consideration of the likely consequences to the parties affected by the rulemaking.

NCUA's safety and soundness regulations protect credit unions, as well as strengthen the credit union system the agency supervises and insures. These regulations reduce the likelihood of credit union failures and, in doing so, promote stability and protect the Share Insurance Fund.

Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

The Dodd-Frank Act does not require any specific cost-benefit analyses from NCUA. It does require cost-benefit analyses from the Consumer Financial Protection Bureau for consumer protection laws and the Federal Reserve Board for the Electronic Funds Transfer Act. In finalizing the rules required by the Dodd-Frank Act, NCUA has completed the Paperwork Reduction Act, the Regulatory Flexibility Act, and the Small Business Regulatory Enforcement Fairness Act analyses that we undertake for our rules.[2]

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[1] 12 U.S.C. 4802.

[2] NCUA has finalized a number of rulemakings required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, such as:

- Revising NCUA's share insurance rules, including making $250,000 the permanent standard maximum share insurance amount;
- Fully insuring the net amount on noninterest-bearing transaction accounts on a temporary basis;
- Modifying the agency's regulations to remove references or requirements related to credit ratings;
- Finalizing a conforming rule on remittance transfers;
- Issuing a joint-agency rule implementing appraisal requirements for higher-priced mortgage loans;
- Rescinding certain consumer protection rules to reflect the transfer of powers to the Consumer Financial Protection Bureau; and
- Finalizing joint-agency standards for assessing diversity policies and practices of regulated entities.

Additionally, NCUA has pending joint-agency rulemakings related to incentive-based compensation and appraisal management companies. NCUA is also working on a joint-agency proposal related to automated valuation models.

Mr. Fazio, a National Credit Union Administration response to an April 8, 2015, letter from Chairman Hensarling and the Financial Services subcommittee chairs reads "Because NCUA has not participated in Operation Choke Point or similar programs, we do not have anything to retract or modify on this subject." The letter goes on to say that the NCUA issued guidance last August that the decision to terminate an account is generally made by a credit union without involvement from the NCUA. There is a larger question of transparency, and isn't related solely to Operation Choke Point. Will the NCUA consider implementing changes similar to those made by the FDIC so that we can have a little more transparency in the exam process?

NCUA seeks to provide as much transparency as possible with respect to our examination policies and procedures. We have historically released all of our examination work plans, as well as our examiner's guides. In recent years, we significantly improved transparency by posting online our *National Supervision Policy Manual* and our supervisory examination guidance in the form of Supervisory Letters. Those letters establish our expectations of examiners on specific supervisory topics and represent the most current expectations for the examination process.

In addition to our August memo to staff, we issued a Supervisory Letter in December 2014 outlining our examination expectations related to higher risk businesses like money service businesses.[3] In that letter, we emphasized that cash intensive businesses like money service businesses provide a valuable service to the community, and credit unions can manage those relationships safely. This letter provides transparency for credit unions about NCUA's examination expectations in this area.

Regarding the FDIC's recent Statement on Providing Banking Services to which you refer as a policy change, NCUA has ***never*** implicitly or explicitly supported the wholesale closing of certain classes of accounts at credit unions.[4] Absent clear and egregious violations of laws or serious safety and soundness concerns, NCUA has not taken the posture of requiring a credit union to open, maintain, or close accounts.

NCUA's risk-based capital proposal sets the risk-weight at a very high 250 percent for mortgage servicing assets, even though the NCUA Board acknowledges that MSAs may provide some hedge against falling rates under certain circumstances but claims this hedging "is subject to too many variables." This would indicate that the proposed risk-weight may be too high, or at least that there is a need to study this issue further. If NCUA enacts this regulation as proposed, it could discourage credit unions from investing in these types of assets, and it may create the unintended consequence of credit unions becoming unable to hedge against future rate changes. Has NCUA conducted a study focused solely on mortgage servicing assets and the impact this new standard will have on credit unions? Given that credit unions are already required to hold capital against these assets, is there any danger in slowing down the process to study the issue further?

The preamble to the January 2015 revised proposed rule on risk-based capital notes that the 250 percent risk weight is appropriate in light of the greater risk inherent in these assets and to

[3] See http://www.ncua.gov/Resources/Documents/SupervisoryLetter_MoneyServices.pdf.
[4] FIL-05-2015 (January 28, 2015).

maintain comparability to the risk weight assigned by the other banking agencies. The value of MSAs are highly sensitive to unexpected shifts in interest rates, prepayment speeds, and servicing costs. These variables contribute to the high level of uncertainty about the ability of credit unions to realize full recorded value for these assets, especially under adverse financial conditions, and support the assignment of a 250 percent risk weight.

While the preamble acknowledges that generally MSAs may provide some hedge against changing interest rates under certain conditions, the risk-based capital proposal is focused primarily on credit risk and therefore the risk weights do not incorporate interest rate risk.

Additionally, MSAs comprise a very small percentage of credit union assets, and revisions to the associated risk weight have very little impact on the proposed overall risk-based capital ratios for individual credit unions. NCUA does not believe the risk weight on this very small amount of credit union assets would be a sufficient disincentive for credit unions to reduce granting loans and retain servicing of their member loans taking into consideration that banks are operating with a similar risk weight.

In developing the proposed rule, NCUA studied the impact of the MSA risk weight on the 432 federally insured credit unions with assets greater than $100 million that reported MSAs.[5] The total amount of MSAs reported was $1.2 billion, with an average ratio of MSAs to total assets of 0.20 percent for credit unions reporting MSAs. The ratio of MSAs to total assets ranged from less than 0.01 percent to 1.32 percent, with only six credit unions reporting MSAs in excess of 1 percent of total assets.

The average risk-based capital ratio for the credit unions reporting MSAs was 17.61 percent using the proposed 250 percent risk weight for MSAs. This is well above the proposed 10 percent risk-based capital level for a well-capitalized credit union. Lowering the risk-weight to 100 percent would increase the average risk-based capital ratio by only 9 basis points to 17.70 percent

NCUA received over 2,000 comment letters on its initial proposal for a risk-based capital system for credit unions, and I understand that the agency has received more than 2,100 comment letters on its second and current risk-based capital proposal with more coming by mail. One of the NCUA Board members has questioned the legality of the current proposal. This is still a very controversial and troublesome proposal. What are the agency's plans and timeline once the comment deadline closes? Has the agency considered withdrawing and revising the proposal?

On the question of the legality of the revised proposed rule on risk-based capital, NCUA has conducted careful due diligence. Debates about the legality of the proposed rule center on NCUA's authority to require credit unions to maintain different risk-based net worth ratio levels to be classified as adequately or well-capitalized. As published in the *Federal Register*, the legal authority section in the preamble of the revised proposed rule outlines NCUA's legal authority to require a two-tiered risk-based capital system.[6]

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[5] The revised proposed rule on risk-based capital would only apply to federally insured credit unions with $100 million or more in assets.

[6] See http://www.ncua.gov/Legal/Documents/Regulations/PR20150115RBC.pdf.

Because the legal issues raised by commenters on the first proposal were so fundamental to the design of NCUA's risk-based capital framework, Chairman Matz decided to obtain an independent legal opinion from an outside law firm on this issue. Of the many law firms considered, the Global Banking and Payment Systems practice of Paul Hastings was chosen. NCUA chose this law firm because its partners have a legal expertise related to prompt corrective action, from the perspective of financial institutions as well as from a federal agency.

In preparing the scope of work, Chairman Matz made it clear that she wanted the firm's unbiased legal opinion on the issue, and that NCUA would not influence or pre-determine the legal opinion. If the opinion found that NCUA did not have legal authority to propose different risk-based thresholds to be well-capitalized and adequately capitalized, then NCUA would have redrafted the proposed rule accordingly. The Paul Hastings opinion concluded that NCUA does have the authority to propose two-tiered risk-based threshold as part of a modernized risk-based capital system.[7] Thus, NCUA's Office of General Counsel and an independent legal opinion have concluded that NCUA has the authority to create a two-tiered risk-based capital system.

On the question of NCUA's plans for proceeding to a final rule, the comment period for the revised proposed rule closed on April 27, 2015. NCUA is currently reviewing all of the comments received and developing a summary report of the ideas, issues, concerns, and questions raised in the comments. Once the summary is complete, agency staff and officials will meet to determine what, if any, changes should be made to the revised proposed rule. A thorough operational and legal review will be completed on any changes prior to submitting a final proposal to the NCUA Board for approval.

After considering all of the comments and information we received, we anticipate submitting a final rule for NCUA Board approval. Chairman Matz has previously said that the agency plans to complete the rulemaking before the end of the year.

[7] See http://www.ncua.gov/News/Documents/NW20150120Opinion.pdf.

House Financial Services Committee Subcommittee on Financial Institutions
Hearing on Examining Regulatory Burdens—Regulator Perspectives
April 23, 2015

Questions for Larry Fazio, Director of the Office of Examination and Insurance, NCUA, from Congressman Juan Vargas

I represent the entire U.S.-Mexico border in California. As you know, border economies raise unique challenges for financial institutions. Sadly, my district has one of the highest incidents of sex trafficking in the country. I know the work you and other regulators do is crucial in preventing those criminal enterprises, as well as labor traffickers, from accessing our financial system. I know your work, indirectly, protects my constituents and their families and I thank you for that.

At the same time, it is important to make sure that honest, hard-working people have access to credit and banking services, especially those in underserved communities. My district has seen four banks close in the last year and another three branches plan to close, leaving whole swaths of the area with only a single financial institution. I understand that this issue is affecting not only my district, but Arizona and Texas as well.

With that in mind, can you speak to any proposals or policies that we can put in place that would prevent further branch closures along the southwest border and potentially incentivize banks and credit unions to open more branches in those regions?

Late last year, NCUA Board Chair Debbie Matz created an internal working group to explore ways to modernize the field-of-membership rules for federal credit unions. In analyzing and exploring the suggestions of the group, NCUA is currently working to find ways to reach into underserved areas though changes in field-of-membership requirements.

From a legislative perspective, NCUA supports changes to the Federal Credit Union Act to give NCUA the authority to streamline field-of-membership changes and permit all federal credit unions to grow their membership by adding "underserved" areas.[8] Allowing federal credit unions with a community or single common-bond charter the opportunity to add underserved areas would open up access for many more unbanked and underbanked households to credit union membership. This legislative change also could eventually enable more credit unions to participate in the programs offered through the Community Development Financial Institutions Fund, thus increasing the availability of credit and savings options in distressed areas.

Congress may also want to consider other field-of-membership statutory reforms. For example, Congress could allow federal credit unions to serve underserved areas without also requiring those areas to be local communities. Additionally, Congress could simplify the "facilities" test

[8] The Federal Credit Union Act defines an "underserved area" as a "local community, neighborhood, or rural district" that meets the definition of an "investment area" under the Community Development Banking and Financial Institutions Act of 1994 and is "underserved by other depository institutions" based on data of the NCUA Board and the federal banking agencies.

for determining if an area is underserved.[9] This concept is another issue being explored by the agency's working group on field-of-membership issues.

NCUA stands ready to work with you and the Financial Services Committee on these ideas, as well as other options to provide consumers more access to affordable financial services through credit unions. We will also provide specific information about the portions of California's 51st Congressional District that qualify as underserved areas directly to your office.

[9]A proposed area that meets the Community Development Financial Institutions Fund's definition of an "investment area" (that is, the area is "distressed" and has "significant unmet needs") must also be underserved by other insured depository institutions, including credit unions.

Questions for Maryann F. Hunter, Deputy Director, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:

1. As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

Section 302 of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act) requires a Federal agency such as the Federal Reserve, in determining the effective date and administrative compliance requirements for certain new regulations that apply to insured depository institutions, to consider any administrative burdens of the rule and any benefits. The Federal Reserve is careful to ensure that any new regulation that will affect insured depository institutions complies with section 302.

More generally, the Federal Reserve takes quite seriously the importance of evaluating the benefits and burdens imposed by our rulemakings. To become informed about these benefits and burdens, before we develop a regulatory proposal, we often collect information through surveys of parties likely to be affected by a rule and meetings with interested parties and their representatives. This helps us craft a proposal that is both effective and minimizes regulatory burden. In the rulemaking process, we also specifically seek comment from the public on the burdens and benefits of our proposed approach as well as on a variety of alternative approaches to the proposal. In issuing a final rule, we seek to adopt a regulatory approach that faithfully reflects the statutory provisions and the intent of Congress while minimizing regulatory burden. We also provide an analysis of the costs to small depository organizations of our rulemaking consistent with the Regulatory Flexibility Act and compute the anticipated cost of paperwork consistent with the Paperwork Reduction Act.

The Federal Reserve believes strongly that public comment can enlighten our regulatory actions and inform our implementation of our statutory responsibilities. Consequently, the Federal Reserve has long followed the practice of providing the public a minimum of 60 days to comment on all significant rulemaking proposals, with longer periods permitted for especially complex or significant proposals.

2. Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

As stated above, the Federal Reserve takes quite seriously the importance of evaluating the benefits and burdens imposed by our rulemakings. To become informed about these benefits and burdens, before we develop a regulatory proposal, we often collect information through surveys of parties likely to be affected by a rule and meetings with interested parties and their representatives. This helps us craft a proposal that is both effective and minimizes regulatory burden. In the rulemaking process, we also specifically seek comment from the public on the burdens and benefits of our proposed approach as well as on a variety of alternative approaches to the proposal. In issuing a final rule, we seek to adopt a regulatory approach that faithfully reflects the statutory provisions and the intent of Congress while minimizing regulatory burden. We also provide an analysis of the costs to small depository organizations of our rulemaking

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Questions for Maryann F. Hunter, Deputy Director, Board of Governors of the Federal Reserve System from Representative Hinojosa:

1. Former Chairman of the Federal Reserve recently came out with a proposal that called for a sweeping re-organization of federal financial regulators, and which called for creating one prudential banking regulator that would regulate and supervise banks rather than having those duties split between your three agencies – the FDIC, OCC and the FRB.

a. Will consolidation of our bank regulators into one agency simplify and ease the regulatory burden faced by community banks? Why or why not?

Consolidation of the Federal Deposit and Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Federal Reserve into a single regulatory agency would not likely provide significant regulatory burden relief for community banks since it would neither eliminate existing regulatory requirements that community banks must comply with nor reduce the number of regulators that supervise a bank.

Each bank is supervised by only one federal supervisor. A bank with a national charter is supervised only by the OCC. A bank with a state charter is supervised by either the FDIC or Federal Reserve. State chartered banks are also supervised by state authorities but generally on alternating schedules with the Federal authorities.

The Federal Reserve also supervises all bank holding companies. In this regard however, the Board recently expanded its Small Bank Holding Company Policy Statement to exempt bank and thrift holding companies with less than $1 billion in assets in total consolidated assets from the Board's regulatory capital rules. Furthermore, the Federal Reserve program for supervising small bank holding companies relies substantially on the work of the bank's primary federal regulator.

In carrying out their responsibilities, the Federal Reserve, FDIC, and OCC continue to collaborate on most major aspects of bank supervision such as development of policies and guidance and on-site examinations. For example, a large portion of the guidance that impacts community banks is developed on an interagency basis through the Federal Financial Institutions Examination Council.

2. From experience, what is the number one regulatory burden complaint your agencies see from community banks?

Supervised community banks frequently raise concerns about the cumulative impact on their business models of new rules governing mortgage lending, which were required by the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). For example, community banks are significant providers of residential mortgages in many markets. As a result, many have reported that new rules governing mortgage lending, such as those included in the Dodd-Frank Act, can have a significant effect on their operations and costs. Most of these rules went into effect in January 2014 and include requirements regarding ability-to-repay standards and qualified mortgages, servicing, high-cost mortgages, Equal Credit Opportunity Act valuations (appraisals under Regulation B), and loan originator compensation and qualification. Interagency appraisal rules also generally went into effect in January 2014 (apart from certain

provisions related to manufactured housing). The Truth in Lending Act-Real Estate Settlement Procedures Act integrated disclosure rule has an effective date of August 1, 2015; however, the Consumer Financial Protection Bureau (CFPB) recently issued a proposal to extend the effective date to October 3, 2015.

While the CFPB has rulewriting authority for the mortgage rules, we understand that these rules are significant and complex. For this reason, the Federal Reserve has been working in a variety of ways to conduct outreach to ensure that the institutions we supervise are aware of and understand the rules. Among other things, we have partnered with the CFPB on a series of instructive webinars through our Outlook Live platform. Outlook Live is an ongoing webinar series on consumer compliance issues that is available to the public and examiners.

The Federal Reserve has also worked to clarify supervisory expectations where we can, and to ensure consistent implementation and examination of these rules at our supervised institutions. For example, we released two interagency statements[1] clarifying our supervisory expectations with regard to the ability-to-repay/qualified mortgage rule. We have also worked through the Federal Financial Institutions Examination Council Task Force on Consumer Compliance to finalize and release interagency examination procedures that our examiners use and that are publicly available. Further, the prudential banking agencies and the CFPB maintain an ongoing dialogue regarding regulatory questions as well as common supervisory issues and trends. We anticipate that as supervisory issues arise, the agencies will continue to coordinate closely.

Generally, the Federal Reserve strives to balance efforts to ensure that supervision and regulation are calibrated appropriately for smaller and less risky institutions with our responsibility to ensure that consumer financial transactions are fair and transparent, regardless of the size and type of supervised institutions involved. Among other efforts, the Federal Reserve has implemented a new consumer compliance examination framework for community banks.[2] While we have traditionally applied a risk-focused approach to consumer compliance examinations, the new program more explicitly bases examination intensity on the individual community bank's risk profile, weighed against the effectiveness of the bank's compliance controls. As a result, we expect that examiners will spend less time on low-risk compliance issues at community banks, increasing the efficiency of our supervision and reducing regulatory burden on many community banks.

3. In your opinion, what is the most important or significant action Congress can take to ease the regulatory burden on our community banks? In your answer, please outline specific proposals.

The Federal Reserve, along with other Federal regulatory agencies, are in the midst of the second decennial review of existing regulations, as required under the Economic Growth and Regulatory Paperwork Reduction Act. The purpose of the review is to remove outdated, unnecessary, or unduly burdensome regulations, thereby reducing regulatory burden on banks. As was the case

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[1] CA 13-15: Interagency Statement on Fair Lending Compliance and the Ability-to-Repay and Qualified Mortgage Standards Rule; SR 13-20/CA 13-23: Interagency Statement on Supervisory Approach for Qualified and Non-Qualified Mortgage Loans.

[2] CA 13-19: Community Bank Risk-Focused Consumer Compliance Supervision Program.

with results from the first review, issued on July 31, 2007, there is a possibility that this review may also identify areas for legislative initiative that can reduce regulatory burden.

In addition, in his March 19, 2015 testimony to the U.S. Senate's Committee on Banking, Housing, and Urban Affairs, Governor Daniel Tarullo recommended revisiting application of the Volcker rule and incentive compensation requirements of section 956 of the Dodd-Frank to community banking organizations. In his testimony he noted that community banks should be excluded since the concerns related to these rules are generally present only with larger institutions, but the Volcker rule by its terms applies to all banking organizations and the incentive compensation provisions apply to all banking organizations with $1 billion or more in assets. As such, the Federal Reserve cannot exempt firms from compliance and legislative action would be required to eliminate this regulatory burden for which the compliance costs to community banks are considered to outweigh the minimal potential safety and soundness benefits.

4. To the extent that you testified that bright-line asset thresholds are not helpful in conducting effective, yet not overly burdensome regulatory oversight, of community banks, which asset thresholds in particular hamper your agency's oversight responsibilities and/or create undue regulatory burdens on community banks?

a. To the extent your answer outlined any particular statutory or other asset threshold, what alternative to said asset threshold does your agency recommend?

In the same March 19, 2015 testimony, Governor Tarullo recommended raising the asset threshold for the Volker rule and incentive compensation requirements to $10 billion, which would exclude community banks from having to comply with the requirements.

"Examining Regulatory Burdens – Regulator Perspective"
House Committee on Financial Services,
Financial Institutions and Consumer Credit Subcommittee
Questions for the Record
April 23, 2015

Questions for David Silberman, Associate Director for Research, Markets, and Regulations, from Congressman Royce:

Question 1
Mr. Silberman, the Dodd Frank Act includes several provisions designed to exclude the business of insurance from the purview of the Consumer Financial Protection Bureau. The Act defines the term the business of insurance to include not only underwriting and reinsurance of risk, but also all acts necessary to the underwriting and reinsuring and the activities related to underwriting and reinsuring, including acts and activities conducted by officers, directors, agents, employees and other persons authorized to act on behalf of such persons. The "acts and activities" under that definition clearly include, and were intended by Congress to include, the sales and marketing of insurance. Since there should be no confusion of Congressional intent on this issue, have there been any internal CFPB conversations to the contrary?

Response

As you note, the Consumer Financial Protection Act (CFPA) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the Consumer Financial Protection Bureau (Bureau) and sets out its authority, includes provisions relating to the "business of insurance." The CFPA refers in several places to "financial products or services," and, in particular, "consumer financial products or services."[1] The CFPA provides an "exclusion" from the definition of "financial product or service" that indicates that the term "does not include . . . the business of insurance."[2] Additionally, the CFPA indicates that "[t]he Bureau may not define as a financial product or service, by regulation or otherwise, engaging in the business of insurance."[3] In addition to the provisions of the CFPA that refer to the "business of insurance," which appear to be the subject of your question, the CFPA also contains provisions relating to "insurance." For instance, the CFPA limits the Bureau's authority over "persons regulated by a State insurance regulator."[4]

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[1] See 12 U.S.C. 5481(15) (defining "financial product or service"); 12 U.S.C. 5481(5) (defining "consumer financial product or service"); see also, e.g., 12 U.S.C. 5531(a) (providing Bureau authority to take certain action "to prevent a covered person or service provider from committing or engaging in an unfair, deceptive, or abusive act or practice under Federal law in connection with any transaction with a consumer for a consumer financial product or service, or the offering of a consumer financial product or service").
[2] 12 U.S.C. 5481(15)(C).
[3] 12 U.S.C. 5517(m).
[4] See 12 U.S.C. 5517(f).

The CFPA defines the "business of insurance" as "the writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons."[5] You indicate that the "acts and activities" under this definition "clearly include, and were intended by Congress to include, the sales and marketing of insurance," and ask whether there have "been any internal CFPB conversations to the contrary." To the best of my knowledge, I am not aware of internal conversations within the Bureau indicating that the sale and marketing of insurance are not included in the "business of insurance" for the purposes of this definition.

Questions for all witnesses, from Congressman Luetkemeyer:

Question 1
As you know, the Riegle Community Development Act of 1994 requires federal banking regulators to conduct a cost-benefit analysis for any rule promulgated. Has your agency adhered to this statutory requirement on all rules promulgated?

Response

The Consumer Financial Protection Bureau (Bureau) is not subject to the Riegle Community Development and Regulatory Improvement Act of 1994 (Act). Section 301 of the Act defines "Federal banking agency" as having the same meaning as in Section 3 of the Federal Deposit Insurance Act (FDIA). Under Section 3 of the FDIA, "Federal banking agency" means: 1) the Comptroller of the Currency; 2) the Board of Governors of the Federal Reserve System; or 3) the Federal Deposit Insurance Corporation.[6]

Please also see response to Question 2.

Question 2
Has your agency conducted the requisite cost-benefit analyses for rulemakings associated with and stemming from the Dodd-Frank Wall Street Reform and Consumer Protection Act?

Response

Yes. As required under Section 1022 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), when the Bureau prescribes a rule under the Federal consumer financial laws, it considers the potential benefits and costs of the regulation to consumers and to persons engaged in offering or providing consumer financial products or services, including the potential reduction of access by consumers to such products or services, the impact on depository institutions and credit unions with $10 billion or less in total assets, and the impact on consumers in rural areas.

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[5] 12 U.S.C. 5481(3).
[6] 12 U.S.C. 1813(z).

In addition, Section 1022 of the Dodd-Frank Act requires that within five years after the effective date of any significant rule or order adopted by the Bureau under Federal consumer financial law, the Bureau must publish a report of its assessment of the rule or order's effectiveness in meeting the purpose and objectives of the Consumer Financial Protection Act of 2010 and any other stated goals for the particular rule or order.[7] The Bureau is committed to this review and, as required under the Dodd-Frank Act, will seek public comment before publishing such reports.

Moreover, shortly after opening our doors in 2011, the Bureau issued a Request for Information to help identify priorities for streamlining inherited regulations. As a result of this early initiative the Bureau identified certain requirements regarding delivery of annual privacy notices under the Gramm-Leach-Bliley Act as unduly burdensome to financial institutions. As a result, in October 2014, the Bureau finalized a rule to allow bank and nonbank financial institutions under certain conditions to post privacy notices online instead of distributing an annual paper copy. As part of the Bureau's commitment to achieving tailored and effective regulations, the Bureau engages in a rigorous process to ensure that its regulations are not outdated, unnecessary, or unduly burdensome.

Questions for David Silberman, Associate Director for Research, Markets, and Regulations, from Congressman Luetkemeyer:

Question 3
CFPB's payday lending White Paper and Data Point research paper have many defects, many of which have been recognized by the Bureau. The recent payday proposal points to a small, parochial Pew study that lacks objectivity. The CFPB claims to be a data - driven agency. How does the CFPB select data on which it bases its studies? Does CFPB analyze all data on a given subject, or all data provided to the Bureau on a given subject? Finally, how does the CFPB utilize and/or incorporate data that does not support a proposed rule?

Response

The Bureau has published two reports detailing its analysis of borrowing patterns with payday loans and deposit advance products.

- In April 2013, the Bureau published a White Paper with initial findings on consumer use of short-term payday loans and deposit advance products.[8]
- In March 2014, the Bureau published a Data Point containing further analysis of the data on short-term payday loans.[9]

Both the White Paper and Data Point contained analysis of de-identified data obtained from a number of storefront payday lenders through the supervisory process. The dataset used includes information on over 12 million loans in 30 states, and each lender provided data for a 12-month time period occurring within 2011 and 2012.

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[7] 12 U.S.C. § 5512(d), Pub. L. 111-203, Title X, § 1022(d) (July 21, 201).
[8] *Available at*: http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.
[9] *Available at*: http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

The Bureau has received another set of data on high-cost installment loans offered by a combination of online and storefront lenders. The Bureau has conducted analysis on this dataset that may inform its rulemaking. We are also analyzing various additional data sources regarding auto title and installment lending, as well as additional sources on payday lending. We are continuing to supplement these analyses. The Bureau will make the results of this research available so that all stakeholders can comment on it as part of the rulemaking process.

As part of its study of the markets for payday, vehicle title and similar loans, the Bureau—in addition to its own research, market monitoring, and supervisory experience—has reviewed relevant academic studies, policy papers, and various other sources of evidence about the impact of these loans on consumers. The Bureau has reviewed academic studies and survey data which industry representatives have cited as supportive of their view that payday borrowers benefit from use of the product. The Bureau has also reviewed a number of studies that draw different conclusions regarding consumer welfare. Bureau staff will continue to review available literature and other evidentiary sources and review and analysis of these sources will inform and be reflected in our rulemaking proposal.

Bureau staff continues to study these markets. When the Bureau issues a formal rulemaking proposal, a detailed discussion will be provided of the evidence the proposal is based on and the underlying legal authority. Members of the public will have a chance to consider the proposal and provide comments and additional information before the Bureau issues a final rule.

Question 4
Why did the CFPB select August 1, 2015, as the date for TRID implementation?

Response
On June 24th, the Bureau issued a proposed amendment to the TILA-RESPA Integrated Disclosure rule, which proposes to move the rule's effective date to October 3, 2015. The Bureau is issuing the proposal to correct an administrative error that would have delayed the effective date of the rule by at least two weeks.

The Bureau is proposing a new effective date of Saturday, October 3. The Bureau believes that a brief delay until early October would minimize the delay-related costs to consumers and those institutions that have worked the hardest at getting ready. We also believe that a brief delay would allow all institutions a chance to adjust to the new effective date and provide for smoother implementation, benefitting both industry and consumers. The Bureau further believes that scheduling the effective date on a Saturday may facilitate implementation by giving industry time over the weekend to launch new systems configurations and to test systems. A Saturday launch is also consistent with existing industry plans tied to the original effective date of Saturday, August 1. The proposal will be open for public comment until July 7.

Prior to making the decision to correct for an administrative error, the Bureau had carefully considered the appropriate effective date when issuing the final rule titled, "Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z)" (Integrated Disclosures Rule or Rule) in November of 2013. Because the Integrated Disclosures Rule, also known as the Know Before You Owe rule, will provide important benefits to consumers, the Bureau was interested in making it effective as

soon as possible. However, the Bureau also understood that the Integrated Disclosures Rule would require creditors, mortgage brokers, and settlement agents to make extensive revisions to their software, to change their dealings and information sharing practices with each other and other settlement service providers, and to retrain their staffs. The Bureau solicited comment on when the Integrated Disclosures Rule should be effective. In particular, the Bureau sought comment on how much time industry needed to make these changes, and specifically requested details on the required updates and changes to systems and other measures that would be required to implement the rule and the amount of time needed to make those changes. After careful consideration, the Bureau decided that August 1, 2015, was an appropriate effective date for the rule.

In making that decision, the Bureau believed that the implementation period was consistent with the statutory purposes of the integrated disclosure requirements in Dodd-Frank Act Sections 1098 and 1100A and past periods provided by Federal regulatory agencies for the implementation of mortgage disclosure rulemakings. The Bureau also believed that this period, on balance, would afford industry sufficient time to implement comprehensive systems changes, integrate business practices into the new regulatory requirements of the Integrated Disclosures Rule, and train staff, all of which will ensure the final rule fully provides the substantial benefits for consumers intended by the Bureau.

The Bureau recognizes that successful implementation poses challenges to industry, provides benefits to both industry and consumers, and in any event requires close collaboration between industry and the Bureau.

As you may know, the Bureau has taken many steps to support industry implementation and to help creditors, vendors, and others affected by the Integrated Disclosures Rule to better understand, operationalize, and prepare to comply with the Rule's new streamlined disclosures. Since the Integrated Disclosures Rule was first issued in November 2013, we have made it a point to engage directly and intensively with financial institutions and vendors through a formal regulatory implementation project. The Bureau's regulatory implementation project for the Rule includes the following:

- **Inter-agency coordination.** In-depth exam procedures were approved by the Federal Financial Institutions Examination Council in February 2015 and published by the Bureau on April 1, 2015. The Bureau's own examination procedures incorporating the FFIEC exam procedures were published on May 4, 2015.

- **Publish "readiness guide," plain-language guides, and other resources.** The "readiness guide" includes a broad check-list of things for industry to do prior to the Rule's effective date. The Bureau has also published a compliance guide, a guide to the new integrated disclosure forms, and an illustrative timeline.[10]

[10] These resources are available at www.consumerfinance.gov/regulatory-implementation/tila-respa/.

- **Publish amendments and updates to the Rule in response to industry requests.** In January 2015, after extensive outreach to stakeholders, the Bureau adopted two minor modifications and technical amendments to the Rule to smooth compliance for industry.[11]

- **Provide unofficial staff guidance.** Bureau staff attorneys have provided oral guidance in response to over 1100 regulatory interpretation inquiries, received from trade associations and through the CFPB_RegInquiries@cfpb.gov email address since the Rule was issued.

- **Engage with stakeholders.** Bureau staff have provided remarks and addressed questions about the Rule and related implementation matters at over 40 formal events and over 50 informal stakeholder meetings since the Rule was issued.

- **Conduct webinars.** The Bureau has conducted a series of five free, publicly available webinars, available for viewing through the Bureau's website,[12] that provide guidance on how to interpret and apply specific provisions.

As previously stated by Director Cordray, the Bureau's oversight of the implementation of the Rule will be sensitive to the progress made by those entities that have squarely focused on making good-faith efforts to come into compliance with the Rule on time. This approach is consistent with the approach the Bureau took to implementation of the Title XIV mortgage rules in the early months after the effective dates in January 2014.

Question 5
The CFPB's response to an April 8, 2105, letter from Chairman Hensarling and the Financial Services subcommittee chairs reads "Your letter also stresses the importance of clarity for financial institutions and examinations staff...The Bureau shares this view, and for this reason we make our Supervision and Examination Manual public on our website." The OCC sent a letter to its exam force, as has the NCUA. The FDIC has changed its examination procedure. Why does the CFPB refuse to issue a simple memorandum?

Response

I understand that Director Cordray's May 7, 2015 letter to you may have touched on this matter. As the Director noted in that letter, this matter relates to reputational risk, which "goes to the safety and soundness of a financial institution[,] . . . [a] primary concern for prudential regulators, but one outside the Bureau's principal responsibilities and expertise." Hence while guidance on this matter could be of substantial relevance to examiners at the prudential regulators, it would be of much less relevance to Bureau examiners, who do not conduct safety and soundness examinations.

As the Director noted in his letter, he shares your view that supervisory decisions should be made on a case-by-case basis rather than through judgment of an entire industry. This point was made by the Director to the Bureau's entire workforce during an All-Hands call in May.

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[11] 80 FR 8767 (Feb. 19, 2015).
[12] These webinars are available at http://www.consumerfinance.gov/regulatory-implementation/tila-respa/.

Questions for David Silberman, Associate Director for Research, Markets, and Regulations, from Congressman Mulvaney:

Question 1
During your appearance before this Committee, I asked you about the CFPB's report entitled "Small Business Advisory Review Panel For Potential Rulemakings for Payday, Vehicle Title, and Similar Loans Outline of Proposals Under Consideration and Alternatives Considered." In that report, on pages 44-45, the CFPB found:

> "The two potential requirements, amortization and off-ramp, have similar estimated effects on the number of loans that could be made. Total loan volume is estimated to decline by between 55 percent and 62 percent...
>
> The amortization requirement is estimated to have a larger effect on principal and fees because the second and third loans in a sequence would be required to be smaller than the first loan. The impact on total fees of the amortization requirement is estimated to be between 71 percent and 76 percent, while the impact of the off-ramp requirement is estimated to be between 60 percent and 65 percent...
>
> This may affect monoline lenders, those specializing in payday lending, particularly severely. Given those impacts, it is likely the case that the number of monoline stores that could operate profitably within a given geographic market would decrease. Some stores might diversify their product offerings, including offering other forms of covered loans, while others might close. The proposals under consideration could, therefore, lead to substantial consolidation in the short-term payday and vehicle title lending market."

Specifically, I asked about the process the CFPB used and the data relied on to develop a proposed rule that would cause consumers to lose access to 60% or more of available short term credit, effectively depriving customers of a needed line of credit.

You testified that the CFPB engaged in a three year process with the "largest data set of loan level anonymized data" to develop this rule. When I asked for this data, you said it was confidential supervisory data and you were not sure if you could provide it to our Committee.

Sir, I have been informed by staff that such data is routinely provided to our Committee for oversight and investigation purposes. As such, please provide the data you relied on to develop the proposed rule and report mentioned above. In addition to that data, please provide the data used to determine that the perceived harm to consumers from short term credit, such as payday loans, justified eliminating consumer access to 60% of loans in the marketplace and driving a majority of lenders out of business.

Response

On December 12, 2013, the Consumer Financial Protection Bureau (Bureau) produced a number of records to the House Financial Services Committee (Committee) including analyses relied upon in the Bureau's own work in developing its proposed rule and previous white papers on this

issue. Committee staff have made clear that they make such records available to Committee Members for review. Some of the data relied upon by the Bureau in developing its proposed rule is highly sensitive and confidential supervisory information and business information belonging to lenders. This data is secured in a database on a protected server at the Bureau. In February 2014, in response to a letter request from Chairman Hensarling, Bureau staff briefed Committee staff on the contents of this database. This briefing, held at the Bureau, included demonstration of the database's operation as well as electronic access to some of the secured data. Routine production of this confidential data would not be feasible or permissible.

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