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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510–6075

July 30, 2019

The Honorable Jerome H. Powell
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

The Honorable Joseph M. Otting
Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street SW
Washington, DC 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Dear Chairman Powell, Comptroller Otting, and Chairman McWilliams:

The United States economy is currently in its longest economic expansion in history, having expanded for 121 consecutive months following the 2008 financial crisis.[1] Although the economic expansion between 2009 and 2016 began as the weakest of any expansion since 1949,[2] economic growth has accelerated in the last two years. In the meantime, the number of banks continues to decline. Since the first quarter of 2009, the number of banks has fallen nearly 35 percent as the number of community banks declined from 7,416 to 4,930.[3] This long-standing trend has only accelerated since the enactment of the Dodd-Frank Act, which applied one-size-fits-all regulations to financial institutions.

A key priority for the Banking Committee last Congress was to enact legislation to spur economic growth and job creation. Following the enactment of the Tax Cuts and Jobs Act in

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[1] *See* https://www.corelogic.com/blog/2019/07/housing-economics-and-growth-in-a-post-recession-america.aspx
[2] *See* https://money.cnn.com/2016/10/05/news/economy/us-recovery-slowest-since-wwii/
[3] *See* https://www.fdic.gov/bank/analytical/qbp/timeseries/ratios-community-noncommunity-banks.xls

2017, the Economic Growth, Regulatory Relief, and Consumer Protection Act (S. 2155) was enacted in 2018 to right-size regulations for community banks, midsized banks, regional banks, and credit unions to expand access to capital and provide needed resources to individuals, households, and businesses across their communities. We have already started to see meaningful benefits from these laws. According to the Bureau of Economic Analysis, the economy has grown at an increasingly faster pace over the last two years, including 2.9 percent in 2018 and 2.2 percent in 2017 after only growing by 1.6 percent in 2016.[4] Employment has also continued to improve with the unemployment rate falling from 4.9 percent in January 2016 to 3.7 percent today, near its 50-year low.[5] In addition, a new report issued by the White House Council of Economic Advisors states that S. 2155 "is expected to reduce regulatory burdens and help to expand the credit made available to small businesses that are the lifeblood of local communities across the nation," and further estimates that S. 2155 "has annual net benefits of almost $5 billion and raises real annual incomes by about $6 billion by removing regulatory burdens from small bank lenders."[6]

More can still be done to support the economic expansion. The Banking Committee continues to explore additional ways that regulations can be tailored to further spur economic growth. As you move forward with finalizing rules implementing S. 2155 and proposing and finalizing other rules, we urge you to consider several critical issues.

Section 201 of S. 2155 simplified the capital regime for highly-capitalized community banks. Instead of subjecting such banks to the extensive reporting requirements and complex calculations of the Basel III risk-based capital requirements, it called for your agencies to develop a simple Community Bank Leverage Ratio (CBLR), of total tangible equity capital-to-total assets, of between 8 percent and 10 percent. Your agencies proposed setting the CBLR at 9 percent and establishing a new Prompt Corrective Action (PCA) framework based on the 9 percent CBLR under which banks would be subject to certain restrictions.

The proposed 9 percent CBLR is well above the current Tier 1 leverage requirement for well-capitalized banks. The purpose of Section 201 of S. 2155 was to simplify the capital regime for community banks and ensure community banks maintain enough capital to weather a downturn. Accordingly, we encourage your agencies to use the discretion provided to you by Congress to establish the CBLR at 8 percent, which would result in community banks receiving relief under the CBLR while maintaining significant capital. This approach would be consistent with law and continue to set a high bar for the amount and quality of equity capital held by community banks.

We also understand the proposal would incorporate a new PCA framework based on the CBLR. The operational restrictions imposed on institutions that fall into less-than-well-capitalized categories have significant negative effects on those businesses. Therefore, if your agencies decide to proceed with the framework for handling less-than-well-capitalized institutions as proposed instead of opting for an alternative approach, we urge you to ensure that the CBLR

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[4] *See* https://fred.stlouisfed.org/series/A191RL1A225NBEA

[5] *See* https://fred.stlouisfed.org/series/UNRATE

[6] *See* https://www.banking.senate.gov/imo/media/doc/The-Economic-Effects-of-Federal-Deregulation-Interim-Report.pdf

thresholds used as proxies for PCA categories are not so punitive as to unintentionally deter qualified institutions from utilizing the CBLR framework.

Reporting requirements are a significant burden on community banks and divert valuable human and financial resources away from economic growth. Section 205 of S. 2155 required your agencies to expand eligibility for short-form call reports to community banks with less than $5 billion in total assets. This provision was purposefully designed to provide for a short-form call report that allows community banks to publish key financial statements two times per year without exhaustive supplemental schedules. In June 2019, your agencies finalized a rule implementing this section by allowing more community banks with less than $5 billion in total assets to file a streamlined call report for the first and third reports of condition for a year. Under the final rule, current short-form call report filers would only save 1.03 hours per quarter, and some stakeholders have expressed concern about the limited relief. We urge you to continue to explore additional opportunities to reduce the regulatory reporting burden for community banks.

The Financial Accounting Standards Board (FASB) announced in 2016 that the current expected credit losses (CECL) accounting standard would replace the incurred losses accounting standard for recognizing credit losses under U.S. Generally Accepted Accounting Principles. CECL has been recognized as the most significant change to accounting standards in the banking industry in decades. Stakeholders have expressed concerns to the FASB, Securities and Exchange Commission (SEC), and your agencies regarding CECL's potential impact on bank lending, especially amid an economic downturn, as well as earnings volatility. We believe it is important that your agencies continue to assist financial institutions by alleviating relevant concerns and offsetting any potential negative effects.

The agencies' option for firms to phase in the day-one regulatory capital effects over three years is a good first step. We also appreciate your commitment to watch carefully how the standard affects lending and the economy. We encourage your agencies to continue to actively analyze the effects to regulatory capital and lending, especially amid a downturn.

We appreciate your work to finalize the proposal to exclude community banks with less than $10 billion in assets that do not engage in meaningful trading activity from Section 619 of the Dodd-Frank Act, as required by S. 2155. Section 619 of the Dodd-Frank Act remains overly complex and introduces significant compliance burdens. We ask your agencies to simplify your recent proposed rule implementing Section 619 of the Dodd-Frank Act, including by eliminating the proposed accounting prong and revising the "covered funds" definition's overly-broad application to venture capital, other long-term investments and loan creation, to improve market liquidity and preserve access to diverse sources of capital for businesses.

Regarding transactions between affiliated entities, we are concerned with the discrepancies in regulators' margin requirements for swaps. As you are aware, the Commodity Futures Trading Commission (CFTC) has exempted transactions between affiliated entities from its initial margin requirements, while your agencies have imposed initial margin requirements for such transactions. As a result, the institutions regulated by your agencies are put at a competitive disadvantage, because they are the only entities that are required to post initial margin between

affiliates. The differences between the CFTC and your agencies run counter to the goal of regulatory harmonization. We ask your agencies to quickly make a targeted change to your margin rule to provide a full exemption from initial margin requirements consistent with the CFTC.

The financial services system is stronger and more resilient than it was before the financial crisis, and we commend the Federal Reserve on its work to ensure that banks can weather a downturn. We have been encouraged by some changes to the Federal Reserve's stress testing regime, including the release of additional information on its stress testing models. The Federal Reserve should continue to evaluate the stress testing regime to identify ways it can be tailored and improved, including around transparency into its models and results. We agree with recent comments by Federal Reserve Vice Chairman for Supervision Randy Quarles that stress testing must continually evolve in order to be relevant and effective. In addition, it is critically important that the Federal Reserve's stress testing regime be significantly simplified for institutions with total assets between $100 billion and $250 billion in accordance with Section 401 of S. 2155.

We appreciate the steps that your agencies took to tailor the regulations of domestic banks and U.S. operations of internationally headquartered banks. We encourage your agencies to continue to examine whether the regulations that apply to the U.S. operations of internationally headquartered banks are tailored to the risk profile and organizational structure of the relevant institutions and consider the existence of home country regulations that apply on a global basis, in connection with the pending proposals and any other potential regulatory changes.

In addition, as you work toward finalizing the aforementioned tailoring proposals, you should consider indexing any dollar-based thresholds in the tailoring proposals to grow over time, generally in line with growth in the financial system. If an institution grows organically in a way that reflects growth in the financial system without a material change to the business model of the firm, it is unlikely the systemic risk profile of such institution would change materially.

The Banking Committee held a hearing earlier this year entitled "Guidance, Supervisory Expectations, and the Rule of Law: How do the Banking Agencies Regulate and Supervise Institutions?" The nature of the supervisory process and the need for trust between supervisor and supervised institution means that sometimes supervisory expectations are communicated in an informal and confidential manner between supervisor and supervised institution, which can be appropriate in certain circumstances, especially when protecting Confidential Supervisory Information. There appears to be a number of situations where your agencies have enacted guidance or other policy statements that are being enforced as rules, and therefore do not comply with notice-and-comment rulemaking processes and do not comply with the Congressional Review Act (CRA). In addition, there have been situations where supervisors make verbal "recommendations" to banks that are inappropriate given the tremendous power supervisors have over banks. We continue to encourage regulators to follow the CRA and submit all rules to Congress, even if they have not gone through a formal notice and comment rulemaking. In addition, we encourage the federal banking regulators to provide more clarity about the applicability of guidance and ensure that supervisors throughout the agencies (especially outside

of Washington, D.C.) know about how guidance should be treated and do not inappropriately use their significant discretion.

Nonbank online lenders play an important role in providing consumers and businesses access to credit, including through partnerships with banks. Unfortunately, the court case *Madden v. Midland Funding, LLC.* (Madden) complicated the bank partnership model by failing to affirm the long-standing "valid-when-made" doctrine. Since Madden, the bank partnership model has been challenged by cases in other jurisdictions outside of the U.S. Court of Appeals for the Second Circuit. Further, banks have also faced similar challenges to their traditional consumer lending activities in courts throughout the country. The Treasury Department's July 2018 report on nonbank financials, fintech, and innovation recommended that your agencies should use your available authorities to address the challenges posed by Madden. Consistent with the recommendations by the Treasury Department, we urge your agencies to use all available authorities to clarify uncertainties introduced by Madden, and to weigh in with courts considering outstanding cases.

It is incredibly important that these issues be addressed over the next year and we encourage you to provide us with regular updates on your progress.

Sincerely,

Mike Crapo
United States Senator

Richard Shelby
United States Senator

Patrick Toomey
United States Senator

Tim Scott
United States Senator

Ben Sasse
United States Senator

Tom Cotton
United States Senator

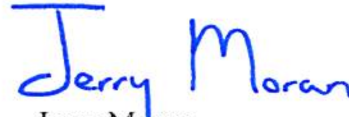
M. Michael Rounds
United States Senator

David A. Perdue
United States Senator

Thom Tillis
United States Senator

John Kennedy
United States Senator

Martha McSally
United States Senator



Jerry Moran
United States Senator

Kevin Cramer
United States Senator