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Statement by

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before the

Committee on Banking, Housing, and Urban Affairs

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

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

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

months: tailoring for firms with assets over \$100 billion that are not global systemically important banks (G-SIBs) and developing a community bank leverage ratio.

### **Tailoring in Post-Crisis Supervision and Regulation**

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

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

### **Regulatory Relief for Community Banking Organizations**

Among the Act's key provisions are targeted tailoring measures to reduce the regulatory burden on community banks. The Federal Reserve is making substantial progress to implement these provisions. To provide clarity to the public, the Board and the federal banking agencies in July issued public statements on the regulations and associated reporting requirements that the Act immediately affected, indicating that we would give immediate effect to those provisions

even before the formal regulatory changes were fully implemented.<sup>1</sup> And in August, the Board began implementing the Act with several interim final rules, which I will describe in more detail.<sup>2</sup>

### ***Small Bank Holding Company Policy Statement***

The Act requires the Board to revise a part of its rules commonly known as the small bank holding company (BHC) policy statement.<sup>3</sup> The small BHC policy statement permits certain small BHCs to incur debt levels higher than would be permitted for larger holding companies and exempts those small BHCs from the Board's minimum capital requirements.<sup>4</sup> This element of the Board's rules aims to facilitate the transfer of ownership in small banks, which can require the use of acquisition debt, while maintaining bank safety and soundness. The Act directs the Board to raise the asset threshold from \$1 billion to \$3 billion for BHCs to qualify for the policy statement, thereby expanding the reach of this regulatory relief.

The Board completed this task on August 28, through an interim final rule. The rule renders most BHCs and savings and loan holding companies with less than \$3 billion in assets

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<sup>1</sup> Board of Governors of the Federal Reserve System, "Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf>.

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

<sup>3</sup> The small BHC policy statement also covers savings and loan holding companies. 12 CFR part 225, appendix C.

<sup>4</sup> Of course, the subsidiaries of these firms remain subject to minimum capital requirements.

exempt from the Board's regulatory capital rules, and provides corresponding relief from comprehensive consolidated financial regulatory reports.<sup>5</sup>

### ***Expanded Eligibility for the Extended Exam Cycle***

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

On August 23, the federal banking agencies adopted an interim final rule to implement these provisions and make parallel changes for U.S. branches and agencies of foreign banks.<sup>6</sup>

### ***Community Bank Leverage Ratio***

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

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

### ***Relief from Enhanced Prudential Standards***

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) originally mandated certain enhanced prudential standards for BHCs with greater than \$50 billion in total consolidated assets as well as company-run stress tests for firms with greater than \$10 billion in assets. The Act exempted BHCs under \$100 billion in assets from these

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

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

requirements immediately upon enactment. To put these provisions into immediate effect, the Board has already stated that it will not take action to require BHCs with less than \$100 billion in assets to comply with requirements related to resolution planning, liquidity risk management, internal liquidity stress testing, the liquidity coverage ratio, debt-to-equity limits, and capital planning, even before formal revisions to the regulations that implement these requirements.<sup>7</sup>

The Board has also stated that it will not collect supervisory assessments for calendar years after 2017 for holding companies with assets under \$100 billion.<sup>8</sup>

### ***Relief from Stress Testing Requirements***

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

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<sup>7</sup> "Statement regarding the impact of EGRRCPA,"

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>.

<sup>8</sup> "Statement regarding the impact of EGRRCPA,"

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>.

<sup>9</sup> Board of Governors of the Federal Reserve System, "Federal Reserve Board releases results of supervisory bank stress tests," news release, June 21, 2018, available at

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180621a.htm>.

<sup>10</sup> The Board announced that it will take no action to require BHCs with less than \$100 billion in assets to comply with company-run stress test requirements. The Board effectively exempted other financial companies regulated by the Board by extending their deadline for compliance with company-run stress test requirements until these firms would benefit from the statutory exemption under the Act, which took effect later than the exemption for BHCs with assets less than \$100 billion. See the "Statement regarding the impact of EGRRCPA,"

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>.

## **Tailoring Regulations for Larger Banking Organizations**

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

### ***BHCs with Assets between \$100 Billion and \$250 Billion***

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

While the statute sets an 18-month deadline for this regulatory process, we expect to move much more quickly than this. Topics covered by such a proposal could include, among

other things, capital and liquidity rules, and resolution planning requirements for the less complex and interconnected of these firms. The statute requires “periodic” supervisory stress testing by the Federal Reserve, which I believe recognizes the value of stress testing but requires a more tailored frequency and requires us to think more carefully about the burden of these tasks. This is consistent with the Federal Reserve’s long standing expectations that all banking organizations, regardless of size, should employ internal risk-management practices that appropriately assess their capital needs and vulnerabilities under a range of reasonably anticipated stress scenarios.

***BHCs with Assets of \$250 Billion or More***

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

***Foreign Banking Organizations***

Under the Dodd-Frank Act, the application of enhanced prudential standards to foreign banks is determined based on total global consolidated assets. The Act raises the threshold for automatic application of enhanced prudential standards under section 165 of the Dodd-Frank Act from \$50 billion in total global consolidated assets to \$250 billion, but the Federal Reserve may continue to apply enhanced prudential standards to foreign banking organizations (FBOs) with



total global consolidated assets between \$100 billion and \$250 billion. The Act does not require the Board to change the U.S. asset threshold for establishment of an intermediate holding company, which is currently at \$50 billion in U.S. non-branch assets.

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

#### **Additional Measures in EGRRCPA**

The provisions I have highlighted focus on the Federal Reserve's tasks that the Board has completed or made a priority for the near term. Two additional measures for which the banking agencies have already issued rulemakings are the treatment of municipal securities in liquidity rules, and the capital treatment of high volatility commercial real estate exposures. Regarding the former, the federal banking agencies completed this task on August 22 through an interim final rule that modified the agencies' liquidity coverage ratio rule to treat certain municipal obligations as high-quality liquid assets as required by the Act.<sup>11</sup> And on the latter, the federal banking agencies released an interagency statement allowing depository institutions and their holding companies to report only commercial real estate loans that would remain subject to the higher capital requirements after implementation of the Act. The Board and the other federal

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

banking agencies then followed up this announcement with a notice of proposed rulemaking on September 18, that seeks comment on changes to our regulation that would implement this statutory amendment.<sup>12</sup>

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

### **Conclusion**

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

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

## **Appendix to the Statement by Randal K. Quarles**

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

### ***Short Form Call Reports***

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

### ***Volcker Rule Relief***

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

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<sup>13</sup> Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Interagency statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018, available at <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706a1.pdf>.

*Other Measures Related to Capital and Liquidity*

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

*Additional Measures*

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