STATEMENT OF

MARTIN J. GRUENBERG
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

Fostering Economic Growth: Regulator Perspective

before the

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

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Chairman Crapo, Ranking Member Brown, and Members of the Committee, I appreciate the opportunity to testify today on legislative and regulatory relief recommendations. My written testimony will begin with an overview of the banking industry's recovery since the financial crisis and its current condition. I will then discuss the FDIC's efforts to streamline and simplify banking regulations and supervisory programs to reduce regulatory burden, particularly for community banks, while preserving the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking industry. That includes a discussion of the federal banking agencies' recently completed review pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) of 1996. Next, I will discuss the FDIC's recommendations for legislative changes to reduce unnecessary regulatory burden on financial institutions. Finally, I will conclude with comments on the recently released Treasury report on financial regulation.

State of the Banking Industry

Nearly a decade after the onset of the worst financial crisis since the 1930s, the U.S. banking industry has experienced a steady recovery that has put it in a strong position to support the credit needs of the economy.

Financial Crisis and Recession

The crisis itself originated in nontraditional mortgage lending, large banking organizations, and investment banks that became critically short of capital and liquidity. The acute disruption of financial markets that began in 2008, and the severe economic downturn that ensued, took a heavy toll on the financial condition of banks of all sizes and on their borrowers.

The U.S. economy lost 8.7 million jobs during and just after the recession. Home foreclosures exceeded two million in each year between 2008 and 2011. Estimates vary as to the total cumulative loss in gross domestic product (GDP) compared to potential output, but these estimates generally exceed $10 trillion.[1]

Banking industry indicators soon followed suit. The quarterly number of problem institutions rose from fewer than 50 in 2006 to a peak of 888 in 2011. Almost 1,800 institutions, or more than one-fifth of all insured depository institutions at the time, were on the problem bank list at some point during or in the aftermath of the crisis. In all, 520 FDIC-insured institutions failed between 2008 and 2016. The balance of the FDIC's Deposit Insurance Fund fell to a low of nearly $21 billion in the red at the end of 2009.

During the crisis and the deep recession that followed, many banks were in critical condition and many borrowers found themselves unable to service debt or unwilling to take on new loans. FDIC-insured institutions held nearly $400 billion in noncurrent loans at the end of 2009 (more than 5 percent of total loans), and charged off more than $300 billion in loans over the next two years.[2] With both the supply of and the demand for credit diminished, the year-over-year change in total loans and leases held by FDIC-insured institutions was negative in 11 out of 12 consecutive quarters starting at the end of 2008.

[1] See Atkinson, Tyler, David Luttrel and Harvey Rosenblum "How Bad Was It? The Costs and Consequences of the 2007-09 Financial Crisis" Federal Reserve Bank of Dallas, Staff Paper No. 20, July 2013. https://www.dallasfed.org/assets/documents/research/staff/staff1301.pdf

[2] Noncurrent loans are the sum of loans and leases 90 days or more past due, and loans and leases in nonaccrual status.

Recovery

The economic expansion that began in 2009 is now approaching its ninth year, making it the third longest expansion on record. The expansion, however, has been marked by the slowest pace of economic growth and the lowest short-term interest rates of any expansion of the past 70 years. In spite of these headwinds, FDIC-insured institutions have made substantial progress in strengthening their capital and asset quality, and in raising their net income to record highs.

The industry's equity capital-to-assets ratio had never exceeded 11 percent prior to the second quarter of 2010. Since mid-2010, it has never <u>failed</u> to exceed 11 percent. The percent of loans considered noncurrent reached a peak of 5.42 percent in the first quarter of 2010. Since then, the noncurrent loan ratio has declined in all but one quarter, and reached a new post-crisis low of 1.34 percent in March of this year. The quarterly ratio of net charge-offs to average loan balances has also fallen to pre-crisis levels below 0.50 percent.

Consistent with these improvements in credit quality, the annual number of failed institutions fell to single digits in both 2015 and 2016, and the number of problem banks fell to a nine-year low of 112 as of March 2017. The Deposit Insurance Fund also steadily recovered, growing to just under $85 billion as of March of this year.

After posting a loss in 2009, annual increases in industry net income have averaged 7.8 percent per year since 2011. FDIC-insured institutions reported a record $171.3 billion in net income for 2016, marking a net increase of 44 percent over the past five years. Only 4.2 percent of all banks failed to post a profit during the year, the lowest share in any year since 1995.

Profitability ratios – that is, return on assets and return on equity – have improved substantially, but not completely, from crisis lows. The most important factor holding back further improvement in bank profitability ratios has been the tight net interest margins (NIMs) banks have earned in the exceptionally low interest rate environment of the post-crisis period. While industry NIMs regularly ranged from 3.5 percent to 4 percent or higher between 1990 and 2005, they have failed to exceed 3.2 percent in any of the last 13 quarters. This squeeze on NIMs can be expected to ease once interest rates normalize and banks can earn wider spreads on their new loans.

As this long economic recovery has progressed, industry loan growth has strengthened in a gradual but sustained manner. Total loans held by FDIC-insured institutions grew by more than 5 percent in 2014, 2015, and 2016, exceeding the rate of growth in nominal GDP in all three years.[3] Year-over-year industry loan growth stood at 4 percent as of the end of the first quarter of 2017, a rate nearly equal to growth in nominal GDP.

Community banks have outpaced noncommunity banks by a number of measures. Their merger-adjusted loan growth has exceeded that of noncommunity banks in each of the past five years; they have increased lending by more than 8 percent in each of the past three years.[4]

Community bank loan growth has been broad-based, exceeding growth at noncommunity banks in each of the past four years in their holdings of one- to four-family mortgages,

[3] Appendix A, Figure 1.
[4] Appendix A, Figure 2.

commercial and industrial loans, and commercial real estate loans. The exception has been consumer loans to individuals – an area of relative strength for large banks. Yet even in that category, community banks have registered positive annual loan growth in each of the past five years.

This vigorous loan growth has translated into healthy increases in net income for community banks. In 2014 and 2016, community bank net income grew by 12.8 percent and 10.1 percent, respectively – far exceeding earnings growth at noncommunity banks during those years. In 2015, earnings growth was identical for both groups at 8 percent.

The state of the community banking sector is of particular importance because of the outsize influence these institutions have on their local economies. Based on the FDIC's research definition of a community bank, they made up 92 percent of all FDIC-insured institutions at the end of 2016.[5] Community lenders are disproportionately important in meeting the diverse credit needs of small businesses. At the end of last year, community banks held 43 percent of small loans to businesses and farms, a share that is more than three times higher than their 13 percent share of industry total assets.

A recent FDIC study showed that community banks held 100 percent of total deposits in 646 U.S. counties or county-equivalents, and more than 75 percent of deposits in another 598

[5] The FDIC's research definition of a community bank was introduced in the 2012 *FDIC Community Banking Study* (see Chapter 1 and Appendix A of the study). The purpose of this definition is to identify community banks according to their lending activity, reliance on core deposits, and limited geographic scope – and not to identify them purely in terms of asset size. The *FDIC Community Banking Study*, as well as historical data identifying community banks according to this definition, can also be found at: https://www.fdic.gov/regulations/resources/cbi/study.html

counties.[6] In all, community banks are the primary source of banking services in 40 percent of all U.S. counties, including rural areas, small towns, and urban neighborhoods across the nation.

An important measure of the effectiveness of our banking system is its ability to make new loans to creditworthy borrowers. As we saw in the crisis, inadequate levels of capital and liquidity at financial institutions can contribute to a collapse of the financial system that severely impairs credit creation and economic output for a protracted period. Conversely, as the capital and liquidity of the U.S. banking industry have recovered, so has the support it has provided to the current expansion.

As noted earlier in this testimony, loan growth at U.S. banks substantially outpaced nominal GDP growth from 2014 through 2016, a sign that banks are supporting economic growth. Bank loans outstanding also have grown faster than loans held by nonbank sources of credit in six of the last seven years. In international comparisons, large U.S. banking organizations as a group are better capitalized than their European counterparts, while economic growth and bank loan growth have been substantially stronger in the United States than in Europe.[7]

International comparisons of non-lending activity also are of interest. The top five investment banks in the world by fee income in 2016 and the first quarter of 2017 all were

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[6] Eric Breitenstein and John McGee, "Brick-and-Mortar Banking Remains Prevalent in an Increasingly Virtual World," *FDIC Quarterly*, Vol 9, No. 1. 2015.
https://www.fdic.gov/bank/analytical/quarterly/2015_vol9_1/fdic_4q2014_v9n1_brickandmortar.pdf

[7] From 2014 through 2016, real GDP grew by 6.7 percent in the U.S. compared to 5.3 percent in euro area. Over the same time period, loans to individuals/households grew by 17.4 percent in the U.S. compared to 3.5 percent in the euro area, and loans to businesses grew by 23.6 percent in the U.S. compared to 1.3 percent in the euro area. Source: FDIC, European Central Bank, European Commission. See Appendix A, Figures 3, 4, and 5.

investment banking subsidiaries of U.S. globally systemic banking organizations. This is broadly consistent with the fact that the volume of corporate bond trading in the United States has increased for several years, but has been flat in Europe.[8] Similarly, the market share of client derivatives cleared by large U.S. banking organizations has increased from roughly 50 percent to 70 percent during the past three years.

In short, the experience of the crisis and its aftermath suggests that a strong and well-capitalized banking system is a source of strength and support to our national economy. The reforms implemented in the post-crisis period have been aimed at making the system more resilient to the effects of future crises or recessions and better able to sustain credit availability throughout the business cycle.

Simplifying Regulation: The Economic Growth and Regulatory Paperwork Reduction Act

It is desirable that financial regulations be simple and straightforward, and that regulatory burdens and costs be minimized, particularly for smaller institutions. In considering ways to simplify or streamline regulations, it is important to preserve the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking industry. The next section of this testimony will discuss changes the FDIC has made, many of which were undertaken in collaboration with the other federal banking agencies, to its regulations or

[8] "Examination of the Liquidity of the Secondary Corporate Bond Markets: Final Report," International Organization of Securities Commissions (IOSCO), February 2017, Figure 8, page 26. See Appendix A, Figure 6.

supervisory programs in the interest of streamlining or simplifying processes, and in reducing regulatory requirements, particularly for community banks.[9]

The Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA) requires the federal banking agencies (the Office of the Comptroller of the Currency, the Federal Reserve Board, and the FDIC), along with the Federal Financial Institutions Examination Council, to conduct a review of our rules at least every ten years to identify outdated or unnecessary regulations. To carry out the EGRPRA review, and to seek comment from bankers and other stakeholders, the agencies published four *Federal Register* notices, each addressing three categories[10] of rules and each providing a 90-day comment period.

In addition to seeking public comment through the *Federal Register* notices, the agencies held six public outreach meetings across the country to provide an opportunity for bankers, consumer and community groups, and other interested persons to present their views directly to agency senior management and staff on any of the regulations subject to EGRPRA review. One of the outreach sessions was specifically targeted toward rural bankers and issues important to them. Altogether, the agencies received more than 250 comment letters from financial institutions, trade associations, and consumer and community groups, as well as numerous

[9] In addition to these measures, the FDIC has also pursued a multi-year Community Banking Initiative. See Appendix B to this testimony.

[10] The agencies grouped their regulations into the following 12 regulatory categories [: (1) Applications and Reporting; (2) Banking Operations; (3) Capital; (4) CRA; (5) Consumer Protection;6 (6) Directors, Officers and Employees; (7) International Operations; (8) Money Laundering; (9) Powers and Activities; (10) Rules of Procedure; (11) Safety and Soundness; and (12) Securities.] During the review process the agencies announced their decision to expand the scope of the EGRPRA review to include recently issued rules, such as those issued pursuant to the Dodd-Frank Act and the recently promulgated domestic capital and liquidity rules. The agencies identified these rules, referred to as "Newly Listed Rules," on a chart included in the third Federal Register notice (see 80 FR.32046 (June 5, 2015), https://www.gpo.gov/fdsys/pkg/FR-2015-06-05/pdf/2015-13749.pdf.

comments from the outreach meetings. The banking agencies submitted our second EGRPRA report to Congress on March 21, 2017.[11]

Several themes emerged during our public outreach process and from the written comments. In particular, the complexity of the risk-based capital rules was cited as being a challenge for community bankers. Additionally, stakeholders suggested that longstanding thresholds set forth in legislation, regulations, or both, should be changed; e.g., dollar thresholds for transactions requiring an appraisal, and asset thresholds on the size of the institutions eligible for longer examination cycles. Commenters also asked that supervisory expectations intended for large banks not be applied to community banks – the so–called trickle-down effect – and that regulators have open and regular lines of communication with community bankers. We also heard concerns about burdens and costs related to Call Reports and suggestions for improving the Call Report preparation process, especially for community banks. Finally, we also heard that regulatory burden does not emanate only from statutes and regulations, but often comes from processes and procedures related to examinations and regulatory oversight.

Interagency Actions in Response to EGRPRA Comments

The agencies have taken, or are in the process of taking, actions to address comments received during the EGRPRA process, including but not limited to, the following:

Simplifying the Capital Rules. The agencies are developing a proposal to simplify the generally applicable capital framework, including: 1) replacing the framework's complex

[11] See 82 FR 15900 (March 30, 2017, https://www.gpo.gov/fdsys/pkg/FR-2017-03-30/pdf/2017-06131.pdf.

treatment of high-volatility commercial real estate exposures with a more straightforward treatment for most acquisition, development, or construction loans; (2) simplifying the current regulatory capital treatment for mortgage servicing assets, so-called timing difference deferred tax assets (DTAs), and holdings of regulatory capital instruments issued by financial institutions; and (3) simplifying the current limitations on minority interests in regulatory capital. The agencies will seek industry comment on the proposal through the normal notice-and-comment process.

Reduced Examination Frequency. Through the EGRPRA process, the agencies all indicated support for revisions to the statute governing examination frequency. Congress subsequently enacted the Fixing America's Surface Transportation Act that, among other things, gave the agencies discretion to raise the asset threshold for certain insured depository institutions qualifying for an 18-month examination cycle with an "outstanding" or "good" composite condition from less than $500 million in total assets to less than $1 billion in total assets. Shortly thereafter, the agencies exercised this discretion and issued a joint interim final rule, which we later finalized, to raise the asset threshold that, in general, makes qualifying institutions with less than $1 billion in total assets eligible for an 18-month (rather than a 12-month) examination cycle. As a result, approximately 611 more institutions potentially qualify for an extended 18-month examination cycle, increasing the share of potentially qualifying institutions to approximately 83 percent. In addition, the change in the examination cycle for certain qualifying institutions reduced the frequency of Bank Secrecy Act reviews that are typically conducted during safety and soundness examinations.

Reduced Regulatory Reporting Requirements. The agencies have worked together on a multi-phase plan to both simplify and reduce regulatory reporting requirements. First, in July 2016, the agencies finalized certain Call Report revisions, which included a number of burden-reducing and other reporting changes that took effect September 30, 2016, and March 31, 2017. Then in August 2016, the agencies proposed for comment a community bank Call Report and finalized it in December 2016. The new, streamlined Call Report for institutions with domestic offices only and less than $1 billion in total assets, reduced the length of the Call Report from 85 pages to 61 pages and removed approximately 40 percent of the data items that were previously included on the existing form. Additional measures proposed this week would remove, raise the reporting threshold for, or reduce the reporting frequency of approximately 8 percent of the data items on the Call Report for small institutions, and make other burden-reducing changes for larger institutions, while continuing to provide the agencies with the information needed to supervise the industry. Further Call Report streamlining is expected in future proposals.

Raising Appraisal Threshold. Community bankers in particular raised concerns that the thresholds for requiring appraisals pursuant to the banking agencies' regulations have not been changed in a number of years, and are particularly low for commercial transactions, effectively requiring an appraisal for most of these transactions. In response, the agencies are developing a proposal to increase the threshold for requiring an appraisal on commercial real estate loans from $250,000 to $400,000, which we believe will reduce regulatory burden in a manner consistent with safety and soundness.

Addressing Availability of Appraisers in Rural Areas. The agencies received a number of comments, particularly from community bankers that participated in the rural banking outreach session, regarding shortages of appraisers in rural areas. In response to these concerns, the agencies issued a statement in May 2017 to regulated entities informing them of the availability of two existing options that may help address appraiser shortages.[12] The first option, temporary practice permits, allows appraisers credentialed in one state to provide their services on a temporary basis in another state experiencing a shortage of appraisers, subject to state law. The advisory also discusses reciprocity, in which one state allows appraisers that are certified or licensed in another state to obtain certification or licensing without having to meet all of the state's certification or licensing standards.

The second option, temporary waivers, sets aside requirements relating to the certification or licensing of individuals to perform appraisals under Title XI of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 in states or geographic political subdivisions where certain conditions are met. Temporary waivers may be granted when it is determined that there is a scarcity of state-certified or -licensed appraisers, leading to significant delays in obtaining an appraisal. At the FDIC, we intend to work to make sure that bankers and other stakeholders are aware of these options, and to encourage our regulated entities to use them when appropriate.

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[12] As noted in the FFIEC's *Joint Report to Congress*, with respect to residential mortgage transactions, other federal government agencies that are involved in the residential mortgage market (such as the U.S. Department of Housing and Urban Development, the U.S. Department of Veterans Affairs, and the Rural Housing Service of the U.S. Department of Agriculture), and the government-sponsored enterprises, which are regulated by the Federal Housing Finance Agency, have the authority to set separate appraisal requirements for loans they originate, insure, acquire, or guarantee, and generally require an appraisal by a certified or licensed appraiser for residential mortgages regardless of the value of the loan (see page 29 of the *Joint Report to Congress*, https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf . However, residential real estate transactions that banks keep on their books and that do not involve these agencies would likely benefit from the existing options that help address appraisal shortages.

Also, some commenters, again primarily in rural areas, were uncertain about whether they were required to obtain appraisals performed by certified or licensed appraisers even when transactions fall below the dollar thresholds in the appraisal regulations. In response, in March 2016, the banking agencies clarified that evaluations may be used in lieu of appraisals when transactions fall below the dollar thresholds in the appraisal regulations.

Reviewing and Modernizing the Examination Process. A number of years ago, the FDIC and other agencies moved away from the one-size-fits-all, “surprise” examination model to a risk-focused examination model that is tailored to the size, complexity, risk profile, and business model of each individual bank. Risk-focused examinations involve significant ongoing communication with bankers and extensive pre-planning to tailor the on-site portion of the examination. That being said, the agencies recognize that regulatory burden does not emanate only from statutes and regulations, but often comes from processes and procedures related to examinations and supervisory oversight, and that we can review our examination processes to improve efficiencies and reduce burden, while maintaining the overall quality of supervision. Accordingly, the agencies are jointly reviewing the examination process, examination report format, and examination report preparation process to identify further opportunities to minimize burden to bank management where possible, principally by rethinking traditional processes and making better use of technology to allow more examination work to be performed off-site, reducing onsite examination hours and the number of examiners present in banks. In addition, the agencies plan to review interagency guidance, such as policy statements, to update and streamline guidance.

FDIC Actions Taken in Response to EGRPRA Comments

Promoting *De Novo* Institutions. Last year the FDIC rescinded its 2009 guidance on *de novo* supervision, FIL-50-2009, "Enhanced Supervisory Procedures for Newly Insured FDIC-Supervised Institutions," reducing from seven years to three years the period of enhanced supervisory monitoring of newly-formed insured depository institutions.[13] The FDIC also issued questions and answers on issues related to deposit insurance applications, clarifying the purpose and benefits of pre-filing meetings, processing timelines, initial capitalization requirements, and business plan requirements. Further, we conducted outreach meetings in all six FDIC regional offices around the country with more than 200 industry participants, providing guidance about the deposit insurance application process. The FDIC has designated subject matter experts in each of our regional offices, providing applicants with dedicated points of contact for deposit insurance applications, and we recently finalized a handbook for organizers of *de novo* institutions, describing the process of applying for federal deposit insurance and providing instruction about the application materials required.[14] In a rising interest rate environment, the FDIC is seeing increased interest in *de novos* and has approved four new applications for deposit insurance in the past nine months.

Reduced Applications Requirements. The FDIC eliminated requirements for institutions to file applications under part 362 of the FDIC Rules and Regulations to conduct activities permissible for national banks through certain bank subsidiaries organized as limited liability companies. The FDIC estimates the vast majority of the part 362 applications processed

[13] FDIC Rescinds De Novo Time Period Extension; Releases Supplemental Guidance on Business Planning (April 6, 2016), https://www.fdic.gov/news/news/press/2016/pr16027.html.

[14] See Applying for Deposit Insurance: A Handbook for Organizers of *De Novo* Institutions, April 2017, https://www.fdic.gov/regulations/applications/handbook.pdf.

during the ten years before the streamlined procedures were adopted involved limited liability companies, so this change will result in a significant reduction in filing requirements.

Reduced Paper-Based Submissions. The FDIC established a process to allow for electronic submission of audit reports required by part 363 of the FDIC Rules and Regulations via FDIC*connect*, eliminating the need for institutions to mail hard copies. FDIC*connect* is a secure, transactions-based website that provides alternatives for paper-based processes and allows for the submission of various applications, notices, and filings required by regulation.

Clarified Capital Rules Treatment for S-Corporations. In 2014, the FDIC issued guidance to FDIC-supervised institutions, clarifying how the agency would treat certain requests from S-corporation institutions 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. The FDIC told banks that unless there were significant safety and soundness issues, the FDIC would generally approve those requests for well-rated banks.

Streamlining Living Will Requirements

The U.S. global systemically important banks have made substantial progress in improving their resolvability and have taken concrete steps to implement important organizational, governance, and operational measures developed in the course of their resolution planning exercises. These firms will be filing new plans on July 1 that should incorporate agency feedback and guidance. The Federal Reserve and FDIC will engage in a full review of these plans.

We are exploring with the Federal Reserve Board ways to improve the resolution planning process. We believe it is worthwhile to consider extending the cycle for living will submissions from annual to once every two years and focusing, every other filing, on key topics of interest and the material changes from the prior full plan submission. In addition, there may be opportunities to greatly reduce the submission requirements for a large number of firms due to their relatively small, simple, and domestically-focused banking activities. Such an approach could limit full plan filing requirements to firms that are large, complex, or have a systemically critical operation.

Recommended Legislative Reforms

Some EGRPRA commenters suggested raising the $10 billion in total assets threshold for conducting annual stress tests set forth in Section 165(i)(2) of the Dodd-Frank Act. The FDIC agrees with these commenters, and supports legislative efforts to increase the threshold from $10 billion to $50 billion. However, the FDIC also believes it is important to retain supervisory authority to require stress testing if warranted by a banking organization's risk profile or condition.

In addition to this recommendation, the FDIC would be receptive to legislation further increasing the asset threshold for banks eligible for an 18-month examination cycle from $1 billion in total assets to $2 billion in total assets. This would allow about another 340 institutions to potentially qualify for extended examination cycles, which would bring the number of qualifying institutions to approximately 93 percent of all institutions. These institutions also would be eligible for extended Bank Secrecy Act and anti-money laundering reviews. Moreover, after notice and comment, the agencies also could consider raising the threshold for the community bank Call Report to match a higher examination frequency threshold.

The FDIC understands the concerns about delays in receiving appraisals, particularly in rural areas, and how such delays can create significant problems in engaging in residential mortgage lending in those areas. In response to these concerns, the FDIC supports legislative changes that would create a new appraisal threshold exemption in that would minimize burden for many community banks. Namely, the exemption would apply to insured depository institutions that originate a *de minimis* number, such as less than 25, of residential mortgage loans in a calendar year with a transaction value of more than $250,000 and secured by properties in rural counties. Additionally, we would propose that the aggregate amount of such transactions (regardless of whether the loans were retained) for each calendar year not exceed a certain level, perhaps 5 percent, of the institution's total equity capital as of the end of the prior year. Institutions meeting such criteria would not be required to obtain appraisals for residential mortgage loans in rural counties regardless of the amount of the transaction, but would be required to conduct evaluations for these transactions in accordance with outstanding guidance.[15] The FDIC believes that such a change would be responsive to community banks in rural areas that have problems in obtaining timely appraisals, while the *de minimis* nature of the proposed exemption limits safety and soundness concerns.

[15] FDIC FIL-82-2010, *Interagency Appraisal and Evaluation Guidelines*, December 2, 2010, https://www.fdic.gov/news/news/financial/2010/fil10082.html
and FDIC FIL-16-2016, *Supervisory Expectations for Evaluations*, March 4, 2016. https://www.fdic.gov/news/news/financial/2016/fil16016.html

The Treasury Report

I now would like to discuss the recently released Treasury Department review of the regulatory framework for the depository sector, focusing for today on two key areas that bear significantly on the FDIC's mission. In general terms, as noted in the report, the financial regulations issued since the crisis were a response to important weaknesses in the pre-crisis financial regulatory framework. A significant body of new rules has been introduced, and there is value in a review of the new framework and its effects. The report contains suggestions regarding tailoring the scope, frequency, and compliance requirements of a number of specific aspects of the new regulations that are worthy of consideration, particularly as they apply to small- and medium-sized institutions. The FDIC is prepared to engage with other interested stakeholders about these issues.

As these proposals are considered, I also would emphasize the important role the post-crisis reforms have had in strengthening the capital and liquidity position and overall financial resilience of the U.S. banking system, particularly for large systemically important financial institutions. As discussed earlier, with their greatly improved capital and liquidity, U.S. banking organizations have provided strong support to U.S. economic activity. Large U.S. banking organizations are better capitalized than their European counterparts, have grown their loans faster, and have been a stronger source of support for the U.S. economy. This is a strength we should preserve and be particularly attentive to when considering changes.

Two specific recommendations in the report bear directly on the FDIC's mission. The first relates to the recommendation to remove the FDIC from the living will process. Resolution plans, or living wills, are an important tool for protecting the economy and preventing future taxpayer bailouts. Requiring these plans ensures that firms establish, in advance, how they could be resolved in an orderly way under the Bankruptcy Code in the event of material financial distress or failure. Currently, the Federal Reserve and the FDIC share responsibility for reviewing these plans. In reviewing these plans, the Federal Reserve brings its perspective as supervisor of the holding company. The FDIC brings its perspective as the agency charged with the resolution of failed depository institutions. Both perspectives have value, and both agencies should remain involved in the review of living wills.

The report also includes several recommendations pertaining to the agencies' supplementary leverage ratio (SLR) and enhanced supplementary leverage ratio (ESLR) rules. The report recommends removing central bank deposits, Treasury securities, and initial margin on derivatives from the denominator of the SLR and ESLR, and recalibrating the numerical requirements for these ratios to be consistent with international standards. During the crisis, leverage capital had greater credibility with financial markets than risk-based capital, and counterparties recognized this. The changes being proposed to the SLR and ESLR would significantly reduce leverage capital requirements for large systemically important banking organizations and significantly weaken the resiliency of the U.S. banking system to future financial stress. For these reasons, the SLR and ESLR requirements should not be weakened.

Conclusion

In conclusion, the experience of the crisis and its aftermath suggests that a strong and well-capitalized banking system is a source of strength and support to our national economy.

The reforms implemented in the post-crisis period have been aimed at making the system more resilient to the effects of future crises or recessions and better able to sustain credit availability throughout the business cycle.

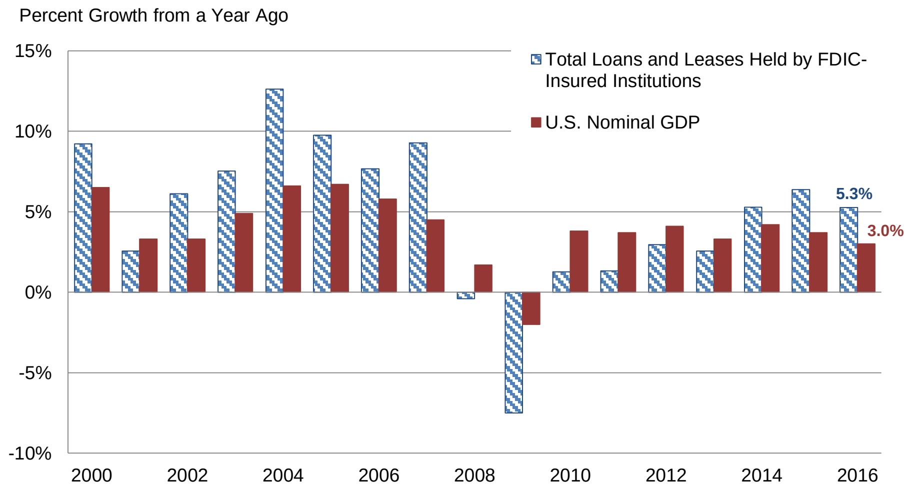
It is desirable that financial regulations be simple and straightforward, and that regulatory burdens and costs be minimized, particularly for smaller institutions. In considering ways to simplify or streamline regulations, however, it is important to preserve the gains that have been achieved in restoring financial stability and the safety and soundness of the U.S. banking system.

Appendix A

Charts Referenced in the Statement

Figure 1

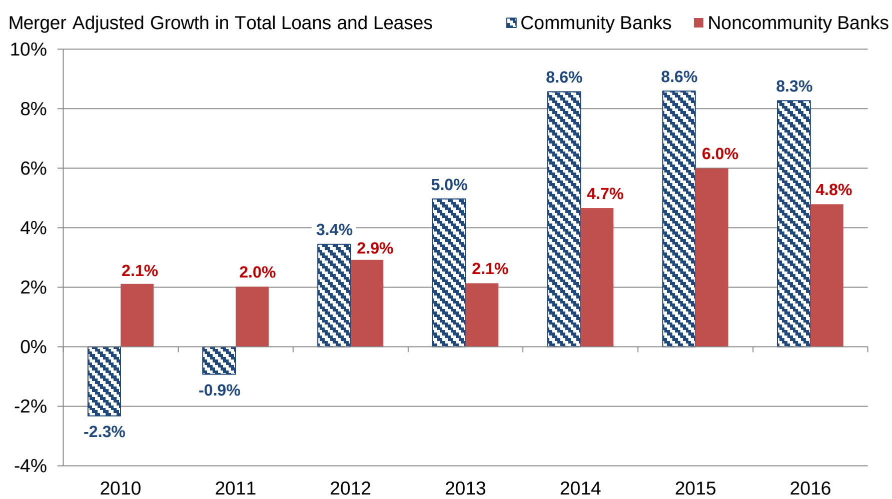
After a sharp decline during the financial crisis, U.S. bank loans have grown faster than nominal GDP in each of the past 3 years.



Sources: FDIC; Bureau of Economic Analysis (Haver Analytics)

Figure 2

Community bank loan growth has exceeded growth at noncommunity banks for five consecutive years.



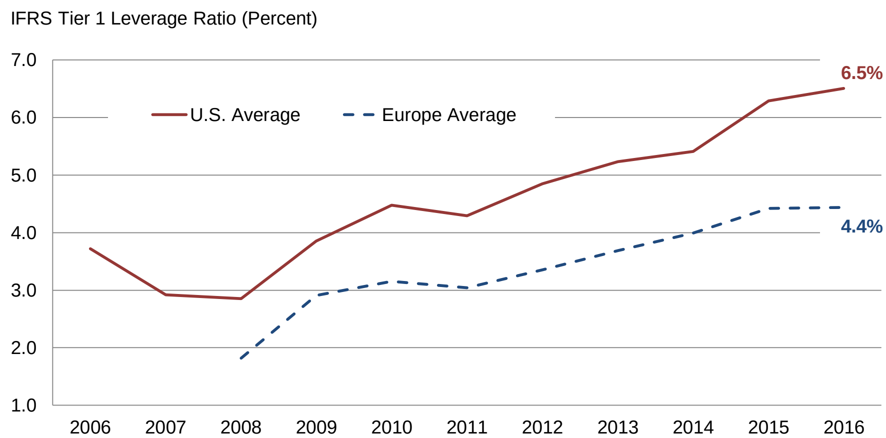
Source: FDIC.

Appendix A

Charts Referenced in the Statement

<u>Figure 3</u>

Large U.S. banking organizations have built their capital faster than European banks.

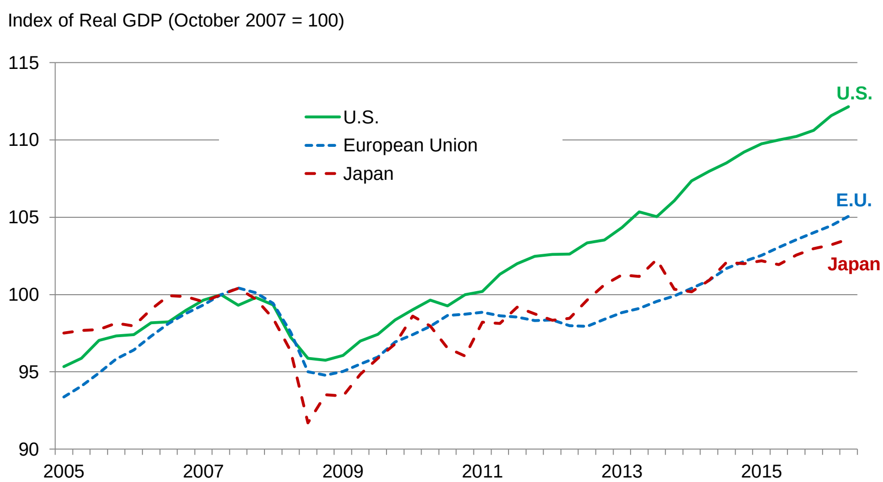


Sources: Y-9C data for U.S. institutions, SNL Financial data for non-U.S. institutions.

Notes: Global systemically important banks (GSIBs) are defined by the Financial Stability Board and include eight U.S. bank holding companies. Certain non-U.S. GSIBs are excluded due to lack of data availability. Estimated IFRS Tier 1 Leverage Ratio is calculated as Tangible Equity / [Tangible Assets + Netted Derivatives Adjustment]. Tangible Equity and Tangible Assets exclude Goodwill and other intangible assets. "Netted Derivatives Adjustment" represents the amount of derivatives with a positive fair value that are excluded from the consolidated balance sheet as a result of netting permitted under GAAP, which approximates the positive fair value that would be reported under IFRS.

<u>Figure 4</u>

The U.S. macroeconomic recovery has outpaced that of the European Union and Japan.



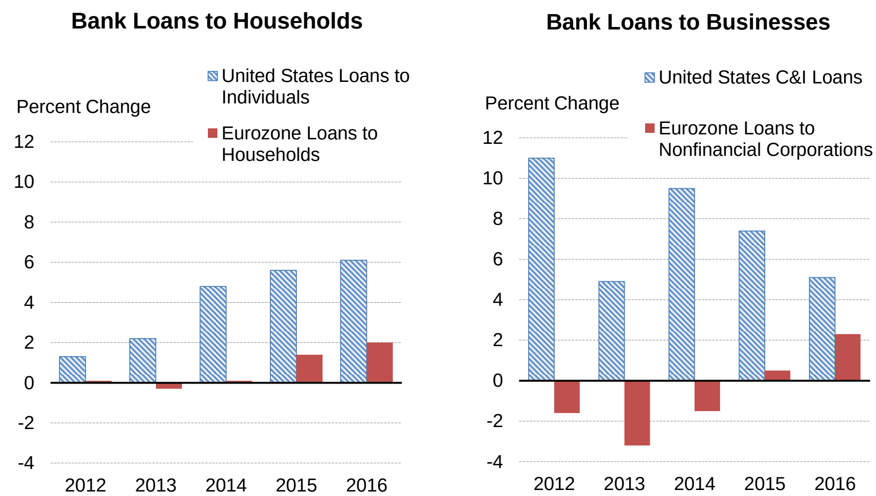
Source: Federal Reserve Bank of St. Louis (FRED).

Appendix A

Charts Referenced in the Statement

<u>Figure 5</u>

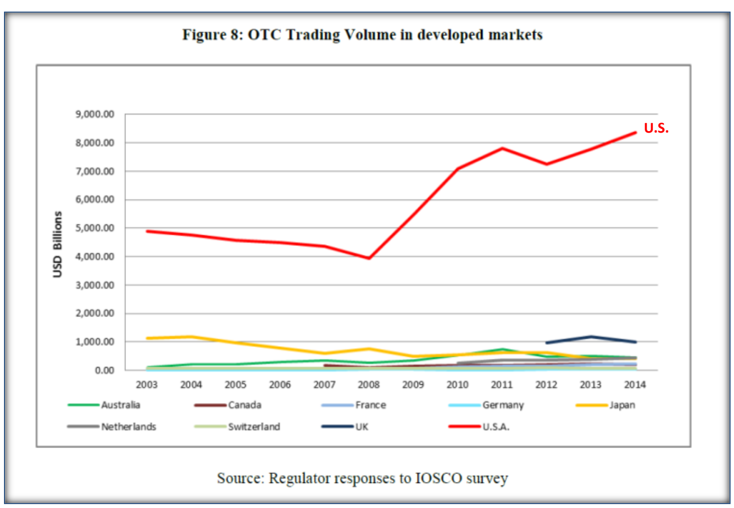
Bank loan growth in the U.S. has outpaced the Eurozone substantially in the post-crisis period.



Source: FDIC, European Central Bank.

<u>Figure 6</u>

The volume of secondary market trading of corporate bonds has surged in the U.S. in the post-crisis period.



Source: "Examination of the Liquidity of the Secondary Corporate Bond Markets: Final Report," International Organization of Securities Commissions (IOSCO), February, 2017, Figure 8, page 26.
https://www.iosco.org/library/pubdocs/pdf/IOSCOPD558.pdf

Appendix B

The FDIC Community Banking Initiative

As the primary federal regulator of most community banks, the FDIC has provided support to community banks under the multi-year Community Banking Initiative. As part of this initiative, we have established the FDIC Advisory Committee on Community Banking to provide the FDIC with advice and guidance on a broad range of important policy issues impacting community banks throughout the country, as well as the local communities they serve, with a focus on rural areas.

The FDIC also has pursued an agenda of research and outreach focused on community banking issues, including the FDIC Community Bank Study, a data-driven analysis of the opportunities and challenges facing community banks over a 25-year period, as well as research regarding the factors that have driven industry consolidation over the past 30 years, minority depository institutions, branching trends, closely held banks, efficiencies and economies of scale, earnings performance, and rural depopulation.[16] We also introduced a Community Bank Performance section of the FDIC *Quarterly Banking Profile* to provide a detailed statistical picture of the community banking sector.

The FDIC has also provided significant technical assistance to community banks. We established a Directors' Resource Center on the FDIC's website that, among other things, contains more than 25 technical assistance videos designed for bank directors and management on important and complex topics. We have revised banker guidance on deposit insurance coverage and conducted related outreach sessions for bankers. We also developed and

[16] See FDIC Community Banking Study, December 2012, https://www.fdic.gov/regulations/resources/cbi/study.html.

distributed to all FDIC-supervised institutions a *Community Bank Resource Kit*, containing a copy of the FDIC's *Pocket Guide for Directors*, and reprints of various *Supervisory Insights* articles relating to corporate governance, interest rate risk, and cybersecurity.

The FDIC also looks for ways to change supervisory processes to improve efficiencies and minimize burdens on community banks. For example, we reduced the frequency of consumer compliance and CRA examinations for small and *de novo* banks in 2013. Previously, small banks (those with assets of $250 million or less) that received a Satisfactory or Outstanding rating for CRA were subject to a CRA examination no more than once every 48 to 60 months, respectively. Small banks with favorable compliance ratings and Satisfactory CRA ratings now are examined every 60 to 72 months for joint compliance and CRA examinations and every 30 to 36 months for compliance only examinations. Additionally, in April 2016, the examination frequency for the compliance and CRA examinations of *de novo* institutions and charter conversions was changed. More specifically, the *de novo* period, which had required annual on-site presence for a period of five years, has been reduced to three years.

We also implemented an electronic pre-examination planning tool for both risk management and compliance examinations. This tool allows the FDIC examination staff to tailor requests for documents and data to ensure that only those items that are necessary for the examination process are requested from each institution. Tailoring pre-examination request lists minimizes burden for institutions, and receiving pertinent information in advance of the examination allows examiners to review certain materials off site, reducing on-site examination hours.

We have improved communication with bank boards of directors and management by reissuing and updating guidance on examination findings[17] to re-emphasize the importance of open communications regarding supervisory findings and to provide an additional informal review process at the Division Director level for banker concerns that are not eligible for another review process. We also improved transparency in the supervisory process, when the FDIC Board of Directors issued two statements that set forth basic principles to guide FDIC staff in developing and reviewing supervisory guidance and communicating supervisory recommendations to financial institutions under its supervision. We also proposed revised guidelines for supervisory appeals to provide more transparency and access to the appeals process. Among other things, these improvements in communication and transparency are intended to avoid the "trickle-down" effect that we sometimes hear about from bankers, and to inform community bankers, in particular, of the avenues available if they feel a regulation or examination process intended for larger banks has been applied to them.

[17] See FIL-51-2016, Reminder on FDIC Examination Findings, July 29, 2016, https://www.fdic.gov/news/news/financial/2016/fil16051.html.