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**Term-Sheet of Regulatory Relief Recommendations for Traditional Banks**

by

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*I. Background*

The new regulations that apply to the banking industry were designed in response to the increasing complexity of the industry. Commercial banks, which by definition have broad access to the safety net, have been engaging in activities previously reserved for investment banks, wealth managers, insurance companies, commercial and industrial firms and other types of businesses.

However, of the approximately 6,400 commercial banks in the US, only a small minority have expanded into these less-traditional activities.

Therefore, regulatory relief would seem to be appropriate for sufficiently capitalized banks engaged in traditional, non-complex banking activities, regardless of the size of these institutions.

*II. Applicability*

Banks that should be eligible for regulatory relief could be defined as those with:

1. zero trading assets or liabilities;
2. no derivative positions other than interest rate swaps and foreign exchange derivatives; and
3. total notional of all derivatives exposures – including cleared and non-cleared derivatives – of less than \$8 billion.<sup>1</sup>

Of the approximately 6,400 commercial banks, only about 400 banks do not meet these three criteria. None of the banks with more than \$100 billion in total assets meet these criteria; however 90 of the more than 4,000 banks with less than \$250 million in total assets also do not meet these criteria.

Such traditional banks have historically been better capitalized than less traditional banks. To acknowledge this historical fact, to ensure that regulatory relief does not result in a less safe and sound banking system, and to provide the proper incentives, some simple measure of capitalization should be added to the list of eligibility criteria for regulatory relief.

In addition to the three criteria above, to be eligible for regulatory relief, a bank should have to have a ratio of GAAP equity to assets of at least 10%. A significant majority of community banks already have an equity to assets ratio of 10% or more, and the threshold is readily achievable for many more.

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<sup>1</sup> Additional criteria could potentially include thresholds related to traditional deposits and traditional loans.

Traditional banks that choose to operate with an equity to assets ratio of 10% or more would then be eligible for meaningful regulatory relief.

### *III. Regulatory Relief*

Dialogue with community banks consistently highlights several areas that are the source of concern over additional regulatory burden. These areas include the new risk-based capital rules, an ever-expanding Call Report (many fields of which aren't relevant for traditional banks), burdensome consumer compliance regulation, appraisal requirement, and the frequency of the examination cycle.

Community banks on their own are not expressing major complaints involving other areas of regulation, including the Volcker Rule, the supplementary leverage ratio, derivatives clearing requirements, increased margin requirements, and other regulations that really only directly impact the large banks and the non-traditional banks. The regulatory burden for traditional banks from these rules is effectively insignificant.

As such, meaningful regulatory relief for traditional banks (i.e. those that meet the three criteria above and chose to have an equity to assets ratio of 10% or higher) can be provided in a manner that is entirely consistent with safety and soundness. Such relief would include:

- Exempt traditional banks from all Basel capital standards and associated capital amount calculations and risk-weighted asset calculations.
- Such banks could also be exempted from several entire schedules on the Call Report, including schedules related to trading assets and liabilities, regulatory capital requirement calculations, and derivatives.
- Eliminate requirements to refer "possible fair lending violations to Justice" if judged to be *de-minimis* or inadvertent.
- Establish criteria that would exempt traditional banks from appraisal requirements.
- Exempt traditional banks, if applicable, from stress testing requirements under section 165(i)(2) of the Dodd-Frank Act.
- Require only an 18 month examination cycle as opposed to a 12 month cycle for traditional banks.

### *IV. Conclusion*

This approach to regulatory relief provides a beneficial and prudent trade-off for banks by incentivizing traditional banking activities. If a bank sticks to traditional banking activities and conduct its activities in a safe and sound manner with sufficient capital, it has less regulatory burden. On the other hand, if a bank elects to expand its activities into non-traditional areas and to use the subsidies that arise from the bank's access to the safety net to fund these activities, such a bank must accept additional regulatory burden to protect the safety net.