STATEMENT OF

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on

EXAMINING THE REGULATORY REGIME FOR REGIONAL BANKS

before the

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Chairman Shelby, Ranking Member Brown, and members of the Committee, I appreciate the opportunity to testify on the regulatory regime for regional banks. My testimony will begin with a profile of the large companies subject to the enhanced prudential standards requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). I then will describe how regulators have implemented the enhanced standards requirements. Finally, I will review various considerations important to any discussion of proposals to change these requirements.

Profile of Large Companies Subject to Section 165

Section 165 of the Dodd-Frank Act requires the Board of Governors of the Federal Reserve System (Federal Reserve) to establish enhanced prudential standards for certain groups of institutions. The Act defines these institutions to include bank holding companies with total consolidated assets equal to or greater than $50 billion and nonbank financial companies that the Financial Stability Oversight Council (Council) has designated for Federal Reserve supervision.

The companies that meet the $50 billion threshold for enhanced prudential standards represent a significant portion of the U.S. banking industry. As of December 31, 2014, 37 companies with combined assets of $15.7 trillion reported total assets greater than $50 billion. They owned a total of 72 FDIC-insured subsidiary banks and savings institutions, with combined assets of $11.3 trillion, or 73 percent of total FDIC-insured institution assets.

The 37 companies represent a diverse set of business models. The four largest companies, holding combined assets of $8.2 trillion, are universal banks that engage in commercial banking, investment banking, and other financial services. Another twenty companies holding $3.3 trillion in assets are diversified commercial banks that essentially take deposits and make loans. The remaining 13 companies, with a combined total of $4.2 trillion in assets, do not engage predominantly in traditional commercial banking activities. These companies include two investment banks, four custodial banks, two credit-card banks, one online bank, and four specialty institutions. The 37 institutions include eight U.S.-owned institutions that are designated as global systemically important banks by the Financial Stability Board. They include the four universal banks, two investment banks, and two custodial banks.

By way of contrast, the FDIC's *Community Banking Study* of December 2012 profiled institutions that provide traditional, relationship-based banking services. The FDIC developed criteria for the *Study* to identify community banks that included more than a strict asset size threshold. These criteria included a ratio of loans-to-assets of at least 33 percent, a ratio of core deposits-to-assets of at least 50 percent, and a maximum of 75 offices operating in no more than two large metropolitan statistical areas and in no more than three states. Based on criteria developed in the *Study*, 93 percent of all FDIC-insured institutions with 13 percent of FDIC-insured institution assets currently meet the criteria of a community bank. This represents 6,037 institutions, 5,676 of which have assets under $1 billion. The average community bank holds $342 million in assets, has a total of six offices, and operates in one state and one large metropolitan area.

The FDIC does not have a similar set of criteria to identify regional banks. Regional banks may be thought of as institutions that are much larger in asset size than a typical community bank and that tend to focus on more traditional activities and lending products.

These institutions typically have expanded branch operations and lending products that may serve several metropolitan areas and they may do business across several states. Regional banks are less complex than the very largest banks, which may have operations and revenue sources beyond traditional lending products.

The 20 holding companies identified as diversified commercial banks -- the subset of the 37 institutions with total assets over $50 billion noted earlier -- have a traditional banking business model that involves taking deposits and making loans, and they derive the majority of their income from their lending activities. Operationally, however, the 20 diversified commercial banks are much more complex than traditional community banks. They operate in a much larger geographic region, and have a much larger footprint within their geographic region.

Of the 20 holding companies:

- Seven have total assets from $50 billion to $100 billion. They have an average of nearly 700 offices, and operate in 12 states and 22 large metropolitan areas.
- Nine have assets from $100 billion to $250 billion. They have an average of nearly 1,200 offices, and operate in 12 states and 24 large metropolitan areas.
- Four have total assets from $250 billion to $500 billion. They have an average of nearly 1,800 offices, and operate in 18 states and 24 large metropolitan areas.

The operational complexity of these 20 diversified commercial bank holding companies presents challenges that community banks do not. Supervisory tools and regulations need to match the complexity of these large $50 billion plus organizations. Any particular institution at the lower to middle part of the grouping may be a dominant player within a particular geographic or market segment and as such may require greater regulatory attention. If there would be a failure, the resolution of any one of these organizations may present challenges. In addition, the failure of more than one of these institutions during a period of severe financial stress could present challenges to financial stability.

Implementation of Enhanced Prudential Standards

Section 165 provides the FDIC with explicit responsibilities in two substantive areas related to prudential supervision: resolution plans and stress testing. In both areas, the FDIC has tailored requirements to fit the complexity of the affected institutions.

Resolution planning

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. The plans also provide important information to regulators, so they can better prepare for failure to protect markets and taxpayers.

In 2011, the FDIC and the Federal Reserve jointly issued a final rule implementing the resolution plan requirements of Section 165(d) of the Dodd-Frank Act (the 165(d) rule) for bank holding companies. The FDIC also issued a separate rule that requires all insured depository institutions (IDIs) with greater than $50 billion in assets to submit resolution plans to the FDIC for their orderly resolution through the FDIC's traditional resolution powers under the Federal

Deposit Insurance Act (FDI Act). The 165(d) rule and the IDI resolution plan rule are designed to work in tandem by covering the full range of business lines, legal entities, and capital-structure combinations within a large financial firm.

Bank holding companies with $50 billion or more in total consolidated assets and nonbank financial companies regulated by the Federal Reserve are subject to the requirement to prepare resolution plans. However, the FDIC and the Federal Reserve used our statutory discretion to develop a joint resolution planning rule which recognizes the differences among institutions and scales the regulatory requirements and potential burdens to the size and complexity of the institutions subject to that rule. The joint rule also allows the agencies to modify the frequency and timing of required resolution plans.

Our resolution plan regulations also are structured so that both firms and regulators are focused on the areas of greatest risk. Smaller, simpler, and less complex institutions have much smaller and simpler resolution plans than more systemic institutions, with complex structures, multiple business lines, and large numbers of legal entities.

In implementing the requirement for resolution plans, the FDIC and the Federal Reserve instituted a staggered schedule for plan submissions to reflect differing risk profiles. The first group of companies required to file plans on or before July 1, 2012, included bank holding companies with $250 billion or more in nonbank assets. This group comprised 11 institutions—seven U.S. bank holding companies and four foreign banking organizations. These institutions generally ranked among the largest institutions in the United States, although some equally large institutions with smaller amounts of nonbank assets, did not file in this group.

The second group was comprised of bank holding companies with $100 billion or more, but less than $250 billion, in total non-bank assets. These firms submitted their initial resolution plans on or before July 1, 2013. The remaining companies, those subject to the rule with less than $100 billion in total non-bank assets, submitted their initial plans on or before December 31, 2013.

Grouping the firms by their holdings of nonbank assets provided the agencies with an initial proxy for firm complexity. By delaying the submission of plans for those with fewer nonbank assets, less complex firms were given more time to prepare. The FDIC and the Federal Reserve also were able to focus on those firms that are more likely to pose serious adverse effects to the U.S. financial system should they need to be resolved under the Bankruptcy Code. Based on their groupings and measured by asset size as of December 2011, no U.S. bank holding company (BHC) with less than $200 billion in total consolidated assets was required to file with either the first or second group of filers.

For their initial submissions, bank holding companies with less than $100 billion in total nonbank assets and 85 percent or more of their assets in an insured depository institution also were generally permitted to submit tailored resolution plans. Tailored resolution plans simplify the task of creating a living will by aligning it with the FDIC's IDI resolution plan requirement and focusing on the firm's nonbank operations. Since the initial filings, the FDIC and Federal

Reserve have further recognized differences among institutions with less than $100 billion in nonbank assets and nearly all U.S. institutions in this category filed tailored plans.

Though smaller firms are less systemic, appropriately tailored resolution plans or other enhanced prudential supervision requirements for these firms provide important benefits. Any particular institution at the lower to middle part of the grouping may be a dominant player within a particular geographic or market segment, and its failure would likely have a sizeable impact for those markets. The Deposit Insurance Fund also would face a substantial loss from the failure of even one of these firms. Finally, the size of these firms presents an obstacle in arranging the sale to another firm as only other larger firms would be likely acquirers. Therefore, the FDIC and Federal Reserve should continue to receive and review resolution plans in order to ensure that a rapid and orderly resolution of these companies through bankruptcy could occur in a way that protects taxpayers and the economy.

Stress testing

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. The Act requires IDIs and BHCs with assets greater than $10 billion to conduct an annual company-run stress test, while BHCs with assets greater than $50 billion must conduct semiannual, company-run stress tests and also are subject to stress tests conducted by the Federal Reserve. The company-run tests must include three scenarios and the institutions must publish a summary of the results.

In October 2012, the FDIC, OCC, and the Federal Reserve issued substantially similar regulations to implement the company-run stress test requirements. The FDIC's stress testing rules, like those of the other agencies, are tailored to the size of the institutions consistent with the expectations under section 165 for progressive application of the requirements. Under the agencies' implementing regulations, organizations in the $10 billion to $50 billion asset size range have more time to conduct the tests and are subject to less extensive informational requirements, as compared to larger institutions. Currently, 107 IDIs are subject to the banking agencies' stress testing rules, with the FDIC serving as primary federal regulator for 28 of these IDIs.

Stress testing requirements are an important risk-assessment supervisory tool. The stress tests conducted under the Dodd-Frank Act provide forward-looking information to supervisors to assist in their overall assessments of a covered bank's capital adequacy and to aid in identifying downside risks and the potential impact of adverse outcomes on the covered bank. Further, these stress tests are expected to support ongoing improvement in a covered bank's internal assessments of capital adequacy and overall capital planning.

Other Regulatory Standards Affecting Regional Banks

Many of the standards required under section 165 address issues that are within the longstanding regulatory and supervisory purview of the federal banking agencies. For example, with respect to banking organizations, the agencies have pre-existing authority to establish regulatory capital requirements, liquidity standards, risk-management standards, and concentration limits, to mandate disclosures and regular reports, and to conduct stress tests or require banking organizations to do so. These are important safety and soundness authorities that the agencies have exercised by regulation and supervision in the normal course and outside the context of section 165.

The FDIC's capital rules are issued pursuant to its general safety and soundness authority and the FDI Act. In many cases, FDIC capital regulations and those of other federal banking agencies are consistent with standards developed by the Basel Committee on Banking Supervision. For example, recent comprehensive revisions to the agencies' capital rules and the liquidity coverage ratio rule incorporated aspects of the Basel III accord, which was developed separate and independent from, and mostly before, the Dodd-Frank Act was finalized.

These capital and liquidity rules play an important role in promoting the safety and soundness of the banking industry, including regional and larger banks. The agencies' capital rules are entirely consistent with the statutory goal in section 165 of progressively strengthening standards for the largest institutions. As a baseline, a set of generally applicable capital rules apply to all institutions. A defined group[1] of large or internationally active banking organizations are subject to more extensive U.S. application of Basel capital and liquidity standards. In addition, eight Global Systemically Important Banks (G-SIBs) are subject to enhanced supplemental leverage capital requirements.

[1] This group consists of banking organizations with total assets of at least $250 billion or foreign exposures of at least $10 billion.

Policy Considerations

Section 165 establishes the principle that regulatory standards should be more stringent for the largest institutions. This idea is rooted in the experience of the financial crisis, where the largest financial institutions proved most vulnerable to sudden market-based stress, with effects that included significant disruption of the real economy. The thresholds in the enhanced prudential standards legislative framework state Congress's expectation for the asset levels at which enhanced regulatory standards should start to apply, while providing for regulatory flexibility to set the details of how those standards should progress in stringency.

In our judgment, the concept of enhanced regulatory standards for the largest institutions is sound, and is consistent with our longstanding approach to bank supervision. Certainly, degrees of size, risk, and complexity exist among the banking organizations subject to section 165, but all are large institutions. Some of the specializations and more extensive operations of regional banks require elevated risk controls, risk mitigations, corporate governance, and internal expertise than what is expected from community banks. We should be cautious about making changes to the statutory framework of heightened prudential standards that would result in a lowering of expectations for the risk management of large banks.

That being said, it is appropriate to take into account differences in the size and complexity of banking organizations when formulating regulatory standards. The federal banking agencies have taken into account such differences in a number of contexts separate and apart from section 165. Examples include asset thresholds for the interagency capital rules, trading book thresholds for the application of the market risk rule, and proposed notional derivatives thresholds for margin requirements. These examples and other size thresholds illustrate that precedents exist apart from section 165 for the application of different and heightened regulatory standards to larger institutions, and that different size thresholds may be appropriate for different types of requirements. Finally, many of the rules that apply to more complex capital market activities do not apply, as a practical matter, to the types of traditional lending activities that many regional banks conduct.

Conclusion

Section 165 provides for significant flexibility in implementation of its requirements. The agencies have made appropriate use of this flexibility thus far, and where issues have been raised by industry, we believe that we have been responsive. The FDIC remains open to further discussion on how best to tailor various enhanced prudential standards and other regulations and supervisory actions to best address risk profiles presented by large institutions, including regional banks.