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June 8, 2020

By electronic submission to www.regulations.gov

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1710; RIN 7100-AF84
Docket No. R-1711; RIN 7100-AF85

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AF45
RIN 3064-AF47

Mr. Jonathan Gould
Chief Counsel
Office of the Comptroller of the Currency
400 7th Street, NW
Suite 3E-218
Washington, DC 20219
Docket ID OCC-2020-0016
Docket ID OCC-2020-0017

Re: Comment letter on "Temporary Changes to the Community Bank Leverage Ratio Framework" and "Transition for the Community Bank Leverage Ratio Framework"

Dear Ms. Misback, Mr. Feldman, and Mr. Gould:

Thank you for the opportunity to comment on the agencies' interim final rules regarding temporary changes to and transition for the community bank leverage ratio (CBLR) framework. We write in our capacities as financial regulatory scholars to caution against further weakening community bank capital standards.[1] Robust capital cushions are essential to ensure that community banks remain a source of credit for small businesses and other borrowers. Strong capital standards are therefore vital to safeguard the banking system against severe balance sheet vulnerabilities related to the COVID-19 pandemic. Accordingly, we urge you not to extend "relief" from the CBLR beyond the accommodations already provided in the interim final rules.

The interim final rules revise the CBLR framework for qualifying community banks established in the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (EGRRCPA).[2] Section 201 of the EGRRCPA directed the agencies to institute a CBLR between 8 and 10 percent. The

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[1] We have written extensively about the risks of deregulating small depository institutions in our article, "Too Many to Fail: Against Community Bank Deregulation," forthcoming in the *Northwestern University Law Review*, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3503692.

[2] Public Law 115-174, 132 Stat. 1296, 1306-07 (2018) (codified at 12 U.S.C. 5371 note).

EGRRCPA provides that a qualifying community bank will be considered to have met all applicable leverage and risk-based capital requirements if it satisfies the CBLR.[3] The agencies set the CBLR at 9 percent in 2019.[4] Shortly thereafter, in response to the COVID-19 pandemic, section 4012 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act temporarily reduced the CBLR to 8 percent until December 31, 2020.[5] The interim final rules implement this provision and provide a one-year transition period to reinstate the 9 percent CBLR by January 1, 2022.

Recent press reports suggest that the agencies will likely receive requests from the community bank sector to lower the CBLR to 8 percent on a permanent basis or otherwise extend the accommodations provided in the CARES Act.[6] **We strongly urge the agencies to resist these efforts and to revert to a 9 percent CBLR by January 1, 2022, as the interim final rules envision. We believe it is critical that the agencies restore the CBLR to 9 percent no later than 2022 for three reasons.**

First, further weakening community bank capital standards could pose serious risks to U.S. financial stability. Contrary to popular perception, small depository institutions can propagate systemic risks, as the United States experienced in the 1980s S&L Crisis and the 2008 financial crisis, when 480 small banks failed.[7] Reducing the CBLR would shrink the cushion that community banks have available to absorb potentially-unprecedented write-downs stemming from the COVID-19 pandemic and could thereby threaten their solvency. When numerous community banks fail simultaneously, small businesses, homeowners, and local communities lose access to needed financial services, compounding the long-term economic damage.[8] Extending the temporary regulatory capital rollbacks in the CARES Act would thus expose the U.S. financial sector to unwarranted economic risks.

Second, weakening the CBLR is not necessary to stimulate lending and economic growth. Indeed, robust capital requirements are consistent with long-term credit expansion. Abundant evidence demonstrates that highly-capitalized banks extend more loans throughout the business cycle.[9] As one

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[3] A qualifying community bank whose leverage ratio exceeds the CBLR is also considered to be "well capitalized" for the purposes of section 38 of the Federal Deposit Insurance Act. *See id.*

[4] Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations, 84 Fed. Reg. 61,776 (Nov. 3, 2019).

[5] Pursuant to the CARES Act, the temporary reduction in the CBLR lasts until the earlier of (1) the termination of the national emergency declaration related to the COVID-19 pandemic, or (2) December 31, 2020. Public Law 116-136, 134 Stat. 281. Under the interim final rules, the 8 percent CBLR would remain in effect until December 31, 2020, regardless of the termination of the national emergency declaration. *See* 85 Fed. Reg. 22,930, 22,932 (Apr. 23, 2020).

[6] For example, on the same day Congress passed the CARES Act, the *New York Times* reported that community banks were "already discussing looking for ways to make [the 8 percent CBLR] permanent." Eric Lipton & Kenneth P. Vogel, *Fine Print of Stimulus Bill Contains Special Deal for Industries*, N.Y. TIMES (Mar. 25, 2020), https://www.nytimes.com/2020/03/25/us/politics/virus-fineprint-stimulus-bill.html. Similarly, an *American Banker* article described community banks' desire to extend the 8 percent CBLR in perpetuity. Neil Haggerty, "Bankers Hope Reg Relief Doesn't End When Coronavirus Does," AMERICAN BANKER (Apr. 7, 2020) https://www.americanbanker.com/news/bankers-hope-reg-relief-doesnt-end-when-coronavirus-does.

[7] *See* Kress & Turk, *supra* note 1, at 9-18 (discussing the role of small depository institutions in previous banking crises).

[8] *See id.* at 18-22 (assessing macroeconomic costs of small bank insolvencies).

[9] *See, e.g.*, Leonardo Gambacorta & Hyun Song Shin, *Why Bank Capital Matters for Monetary Policy* 18-19 (BIS Working Paper No. 558, 2016) (finding that a 1 percentage point increase in the leverage ratio is associated with a 0.6 percentage point increase in annual loan growth in a cross-country study); Benjamin H Cohen & Michela Scatigna, *Banks and Capital Requirements: Channels of Adjustment* 21-22 (BIS Working Paper No. 443, 2014) (finding that banks with higher capital ratios at the end of 2009 experienced stronger credit growth than peers in the ensuing three years); *see also* Thomas M. Hoenig, Vice Chairman, Fed. Deposit Insurance Corp., Remarks on Bank Supervision presented at the Federal Reserve Bank of New York (Mar. 18, 2016), https://www.fdic.gov/news/news/speeches/spmar1816.html ("Going into the crisis of 2008, banks holding an average 12 percent capital saw more modest declines in loans and a quicker recovery. In contrast, banks

expert put it, "better capitalized banks lend more, not less, than weakly capitalized ones."[10] Further relaxing the CBLR would therefore undermine the goal of sustainable, long-term credit creation.

Finally, despite claims to the contrary, community banks do not require regulatory relief in order to compete with larger financial institutions. In fact, community banks' market share has increased since the 2008 financial crisis, and they remain just as profitable as they were before Dodd-Frank.[11] As FDIC Chairman Jelena McWilliams stated at the end of last year, "community banks reported another positive quarter," with "the annual loan growth rate at community banks outpac[ing] the overall industry's growth rate."[12] The community bank sector's strong competitive position belies any need for additional regulatory accommodations.

In sum, we urge the agencies to allow the CBLR to revert to 9 percent by January 1, 2022, as contemplated in the interim final rules. Community banks provide critical products and services to businesses and households that are underserved by larger financial institutions. Further weakening community bank capital standards would threaten the long-term viability of this important sector. By contrast, reinstating the 9 percent CBLR would help ensure that community banks remain a vital source of credit throughout the economic cycle.

Thank you again for the opportunity to comment on the interim final rules.

Sincerely,

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with capital below 8 percent … experienced more dramatic declines in lending. Strong capital levels support growth over the business cycle and are good for the economy.").

[10] MORRIS GOLDSTEIN, BANKING'S FINAL EXAM 28 (2016).

[11] *See* Kress & Turk, *supra* note 1, at 31-35 (discussing the community bank sector's strong financial performance since 2008).

[12] Jelena McWilliams, Chairman, Fed. Deposit Insurance Corp., Remarks on the Fourth Quarter and Full-Year 2019 Quarterly Banking Profile (Feb. 25, 2020), https://www.fdic.gov/news/news/speeches/spfeb2520.html.