## Subcommittee on Financial Institutions and Consumer Credit
## Hearing Entitled
## "Legislative Proposals for a More Efficient Federal Financial Regulatory System: Part II"
## Testimony of Anthony Cimino

Chairman Luetkemeyer, Ranking Member Clay, Members of the Subcommittee, thank you for the opportunity to testify before the Subcommittee on Financial Institutions and Consumer Credit.

My name is Anthony Cimino, I am Senior Vice President and Head of Government Affairs at the Financial Services Roundtable. I am appearing today on behalf of FSR's membership, which is comprised of the CEOs and senior executives of the nation's leading banking, asset management, and insurance institutions, card companies, and other financial institutions. Today I will focus my testimony on *H.R. 3179, the "Transparency and Accountability for Business Standards Act,"* sponsored by Representative Hollingsworth, and *H.R. 3746, the "Business of Insurance Regulatory Reform Act"* sponsored by Representatives Duffy and Moore.

I would like to note that although the Financial Services Roundtable is submitting this testimony, both of these legislative initiatives have broader industry support, and fellow trade associations have worked to drive policy and advocacy efforts on these important bills.

FSR applauds the Committee's leadership and supports efforts to assess and modernize the regulatory system. In the past decade, Congress, financial regulators, and the financial industry itself have acted to strengthen the financial system and to address gaps. FSR believes it is important to assess the impact of a wide variety of post-crisis reforms and take appropriate action to recalibrate the regulatory system to address risks and create economic opportunity for all Americans.[1]

The goal of FSR and its members is to ensure that the financial system can meet the needs of consumers and business while maintaining the confidence of shareholders and counterparties, and the soundness of the broader market. We can achieve this objective when regulators carefully implement new regulations to ensure they are tailored to market needs and avoid regulatory duplication. Following these principles ensures that the financial regulatory system works to grow American economic opportunities.

Today I will speak in favor of two bills that seek to reduce overlap and maintain the competitiveness of U.S. markets both domestically and globally.

### H.R. 3179, the "Transparency and Accountability for Business Standards Act"

FSR supports *H.R. 3179, the "Transparency and Accountability for Business Standards Act,"* sponsored by Representative Hollingsworth. This legislation would require federal banking agencies to provide a rationale and perform an in-depth analysis when promulgating prudential standards that impose different requirements than related international standards. Legislation in this area is needed to address multiple areas where U.S. standards are currently out of step with non-U.S. institutions.

[1] Letter from the Financial Services Roundtable to Craig Phillips, Counselor to the Secretary, U.S. Department of the Treasury, May 3, 2017. Available at http://www.fsroundtable.org/wp-content/uploads/2017/06/FSR-Letter-to-Treasury-on-Core-Principles-May-3.pdf.

*Strength of the Banking Sector*

Since the crisis, the financial system has grown more resilient and better capitalized. Between the first quarter of 2009 until the end of 2016, common equity capital ratios at the nation's largest banks increased from 5.5% to 12.5% representing a new capital cushion of $750 billion.[2] The amount of liquid assets on bank balance sheets has also risen dramatically. For example, the eight most closely regulated U.S. institution now hold about $1.7 trillion of cash or treasury securities on their balance sheets, representing over 15% of their total assets.[3]

The Federal Reserve's most recent stress tests of bank balance sheets show financial institutions would be resilient and well capitalized even when facing severely adverse economic conditions. The 2017 stress test scenario included a severe recession, double-digit unemployment rates, and high-rates of corporate loan and commercial defaults. The post stress test results, however, projected bank capital levels that were still higher than 2009 capital levels.[4]

As some commenters have noted, however, the rebound in our country's financial stability has not been met with a particularly strong economic recovery. Weak growth in several areas, including small business and mortgage borrowing has been pronounced.[5] As noted in several regulatory reports issued by the Treasury Department this year, FSR believes better-tailored regulation can spur greater economic growth.

*Basel Committee & U.S. Regulatory Implementation*

Beginning the 1980s, the Basel Committee on Banking Supervision, an international body which now includes representatives from 28 different jurisdictions, has adopted various recommendations with the intent of encouraging the adoption of prudential standards that protect the stability of the international banking system. Importantly, any internationally agreed-upon standards that are released by the Basel Committee or other similar organizations are subject to separate adoption by U.S. agencies under the requirements of the Administrative Procedure Act.

Starting in 2010, the Basel Committee began finalizing elements of Basel III, its most recent capital standards recommendation. The new accord provided for heightened capital and liquidity requirements to enhance the stability of internationally active banks.

Importantly, in implementing many of the Basel III standards, which focus most acutely on the nation's largest bank holding companies, the Federal Reserve Board and other U.S. banking regulators have pursued a policy of "gold plating" or heightened prudential scrutiny. This means in many instances where international supervisory bodies have agreed upon a specific prudential standard, the Board, FDIC, or OCC has subjected U.S. bank holding companies to even more stringent requirements, imposing additional capital and liquidity requirements.

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[2] Board of Governors of the Federal Reserve System, COMPREHENSIVE CAPITAL ANALYSIS AND REVIEW 2017: ASSESSMENT FRAMEWORK AND RESULTS ("CCAR 2017"), June 2017, 2.
[3] U.S. Department of the Treasury, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS ("Treasury Report on Banking"), June 2017, 37-38.
[4] CCAR 2017, 2-4.
[5] Treasury Report on Banking, 43-48.

At a macro level, the U.S. regulators' implementation of the related Basel III standards requires that banks maintain high-levels of risk absorbing capital (CE TI), far in excess of pre-crisis levels. The Liquidity Coverage Ratio (LCR) requires that covered banks keep enough cash and other high-quality liquid assets (HQLA) to protect themselves against severe market shocks. The Supplemental Leverage Ratio (SLR) was established as a backstop to risk-weighted capital requirements and is similar to leverage ratio requirements that, while not used elsewhere, are already binding on U.S. institutions. The SLR differs, however, by including more items, including certain off-balance sheet calculations, in determining a bank's capital requirement.

*Enhanced Capital Surcharges on Institutions Defined as G-SIBs*

Basel III imposes a capital surcharge on Global Systemically Important Banks (G-SIBs). U.S. regulators adopted a G-SIB surcharge consistent with international agreements (method 1), but then adopted an additional requirement (method 2) that set forth a more prescriptive ("gold-plated") surcharge beyond the international standard. Method 1 is based on the internationally accepted G-SIB surcharge framework, which produces a score derived from a firm's attributes in five categories: size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability. Method 2 replaces method 1's substitutability category with a measure of a firm's reliance on short-term wholesale funding, which, in nearly all cases, produces a higher surcharge. The Method 2 methodology has proven costly. In some cases it has forced an extra 2 percent capital charge in addition to the international standard.

To bolster US competitiveness relative to foreign firms, FSR supports a review and possible elimination of the method 2 requirement, which has required firms to hold billions in excess capital beyond what was contemplated or suggested within the Basel standard. According to one estimate, the method 2 methodology used by the Federal Reserve has reduced the lending capacity of the U.S. financial system by $287 billion dollars.[6]

H.R. 3179 would enable this review, allowing for an analysis of the surcharge's ramifications on the competitiveness of U.S. firms. Regulators would undertake a cost-benefit analysis to comprehensively scope the impact of the rule U.S. economic growth and determine if other regulatory requirements, such as annual capital planning and stress testing exercises, might justify the adoption of a standard that more closely tracks the attributes adopted by the Basel Committee. Conducting this review allows the Federal Reserve the flexibility to reach similar policy outcomes, but ensures that key rules which impact nearly all aspects of the U.S. financial system are tailored based on a thorough and robust process.

*Enhanced Supplementary Leverage Ratio (eSLR) Requirements*

Following international agreements, U.S. banking regulators imposed a 3 percent SLR requirement on bank holding companies with more than $250 billion in assets and more than $10 billion in on-balance sheet foreign exposures. In 2014, however, U.S. regulators adopted an eSLR requirement for the eight U.S. bank holding companies classified by the Financial Stability Board as G-SIBs. The eSLR requires these G-SIBs to meet a 5% SLR requirement at the holding company level and a 6% eSLR requirements (double the international standard) at the bank level. Foreign banks in most

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[6] Bank of America Merrill Lynch, *Treasury Proposal Could Unlock $2tn of Balance Sheet Capacity*, June 13, 2017, 3.

jurisdictions are not subject to this enhanced SLR requirement which has important implications for the ability to U.S. firms to be competitive in the market for certain financial products.

Taking action to modify the eSLR requirement may provide covered institutions with up to $300 billion in increased balance sheet flexibility to meet the needs of certain markets, especially certain business customers.[7] The SLR is a non-risk weighted measure, meaning it can be biased against activities that, while stable, provide only limited financial returns such as clearing and settlement services.

Consistent with the principle that U.S. regulations enable American companies to be competitive with foreign firms, we support the reconsideration of the eSLR requirement.

*Liquidity Coverage Ratio*

The liquidity coverage ratio (LCR) requires banks to hold enough high-quality liquid assets (cash, treasury securities, etc.) or HQLA to withstand a severe 30-day stress scenario. This is a reasonable policy goal to ensure that banks will meet their obligations to depositors. Higher required amounts of liquid assets, however, reduce the investments that financial institutions can make into loans and other investments that create jobs and grow the economy.

In setting the LCR, however, U.S. agencies again deviated from the internationally agreed upon standards in key areas, including Adjustments to Cash Flow Assumptions and Revisions to Maturity Assumptions for Options. In addition to harmonizing with international standards, making the following suggested revisions to the LCR would also diminish the need for institutions to unnecessarily hold higher levels of LCR-approved liquid assets in lieu of utilizing their resources to make loans and other direct investments into the economy:

*Adjust Cash Outflow Assumptions*

FSR supports reforms to the calculation of net cash outflow (the denominator of the LCR) so that it better aligns with the Basel agreement. Currently, the U.S. LCR overstates the factors used to project the extreme stress scenario when compared to other jurisdictions. Appropriate changes would include: (1) eliminating the maturity mismatch add-on component of the U.S. LCR calculation in place of cumulative net cash outflow amounts; and (2) allowing net cash outflows to be calculated on the final business day of every month instead of daily. Additionally, the agencies should modify excessively conservative and unrealistic cash outflow rates and assumptions to align with international standards. For example, the final U.S. LCR rules provide for 0% liquidity value for non-operating commercial deposits and excess operational deposits of financial institutions. Reviewing this portion of the rule, as directed under H.R. 3179, will enable regulators to better refine its standards for operational deposits or to conduct further analysis on how U.S. liquidity rules compare to non-U.S. jurisdictions

*Revise Maturity Assumptions for Options*

The LCR rule contains certain maturity assumptions for capital markets options. These assumptions require covered firms to assume the worst possible cash outflow outcome when

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[7] See *Global Capital Index*, June 30, 2017 available at https://www.fdic.gov/about/learn/board/hoenig/capitalizationratio2q2017.pdf.

determining the maturity of an exposure, an especially punitive approach. The Basel Committee did not include that approach, which discourages reliable risk management practices and imposes a higher net cash outflow cost on U.S. banks making. This outcome hinders the ability of banks to provide the liquidity and credit facilities that are cornerstones of traditional commercial banking.

By contrast, under the Basel Committee approach, banks are subject to a more principles-based framework where they need to consider stressful scenarios and incorporate the BCBS Principles for Sound Liquidity Risk Management and Supervision. We recommend that U.S. regulators align their maturity assumptions with international standards. A more principles-based approach, combined with liquidity stress testing, would likely ensure appropriate attention to risk without placing U.S. firms at a competitive disadvantage to foreign firms. Such changes, furthermore, would not need to undercut the strong liquidity position of U.S. banks. Even a 1 basis point change in LCR requirements would provide assets to fund $170 million in additional loans or other investments.

These are some examples of U.S. deviation, or gold-plating, international standards. FSR is not advocating for sovereign countries to delegate regulatory authority to international bodies, nor are we asking for mandated uniformity. We are merely asking for a clear, transparent assessment and rationale to explain deviations that impact U.S. competitiveness and potentially disrupt the marketplace.

## H.R. 3746, the Business of Insurance Regulatory Reform Act

FSR supports *H.R. 3746, the Business of Insurance Regulatory Reform Act,* sponsored by Representatives Duffy and Moore. This legislation would clarify the Consumer Financial Protection Bureau's authority with respect to persons regulated by a State insurance regulator.

Title X of the *Wall Street Reform and Consumer Protection Act*, the Dodd-Frank Act, established the Consumer Financial Protection Bureau (CFPB) and charged it with the enforcement of specific consumer protections. Title X of Dodd-Frank also exempted the business of insurance from CFPB authority. The Dodd-Frank Act defines the "business of insurance" as the following:

> The writing of insurance or the reinsuring of risks by an insurer, including all acts necessary to such writing or reinsuring and the activities relating to the writing of insurance or the reinsuring of risks conducted by persons who act as, or are, officers, directors, agents, or employees of insurers or who are other persons authorized to act on behalf of such persons.

H.R. 3746 seeks to reiterate and clarify that insurance regulation is the purview of state insurance regulators. The legislation also includes a rule of construction that construes deference to State regulators.

Legislators seemingly elected to exempt insurance from CFPB authority because of the strong state-based insurance regulatory framework. The McCarran-Ferguson Act contains a provision which delegates to States the power to regulate the business of insurance by providing that:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or

> which imposes a fee upon such business, unless such Act specifically relates to the business of insurance.[8]

Despite this, the CFPB has expanded its scope and activities. In 2016, the CFPB issued a *Request for Information on Payday Loans, Vehicle Title Loans, Installment Loans, and Open-End Lines of Credit*. As part of this RFI, the CFPB was requesting information on credit insurance, which is an insurance product regulated by the States. This CFPB action impinges on statutory exemption the Dodd-Frank Act provided and moved into the business of insurance.

*The Arbitration Rule and Policy Loans*

Another example of CFPB mission creep into the business of insurance is in the CFPB's Proposed Rule on Arbitration Agreements. The proposal sought to apply the Arbitration rule to the extension of credit by whole life insurance policy providers. These "policy loans" are loans secured by the cash surrender value of the related policy. According to a comment submitted by the National Association of Insurance Commissioners (NAIC), "The policyholder taking out a policy loan is not an applicant seeking credit to defer payment of a debt, incur debt or defer its payment, or purchase property or services and defer payment." [9]

The underlying CFPB rationale was to apply its arbitration rules to entities covered under the Equal Credit Opportunity Act (ECOA). To this point, and reiterating the CFPB's misapplication of its proposed rule, the NAIC argued that life insurance policy providers are not "creditors" under ECOA. The same NAIC comment letter continued, "While there is a general expectation that the policy loan will be repaid, that does not make the policy provider a creditor as defined by ECOA. If a policyholder does not repay the loan, the policy benefits are simply reduced by the outstanding balance of the loan."

*Clarifying Intent & Legislative Action*

In addition to Congress's decision to grant States the authority to regulate the business of insurance, the Treasury Department's recent report endorsed the existing state-based regulatory system.[10] FSR supports the state-based system of insurance regulation and seeks to ensure that insurance companies do not face duplicated regulations at the Federal and State level. The state-based system has provided effective oversight of the insurance marketplace and has robust consumer protections. This legislation – and the original vision of the Title X – does not diminish consumer protections related to insurance, but maintains robust framework and protections at a State level.

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The Financial Services Roundtable again commends the Subcommittee for its leadership and desire assess and optimize the regulatory system. *H.R. 3179, the "Transparency and Accountability for Business Standards Act,"* provides a mechanism for a transparent assessment

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[8] 15 U.S.C. § 1012(b).

[9] NAIC Submission re: Docket No. CFPB-2016-0020; RIN 3170-AA51 – Arbitration Agreements. August 4, 2016

[10] U.S. Department of the Treasury, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: ASSET MANAGEMENT AND INSURANCE, October 2017, 107-108.

and rationale for regulatory deviations between the U.S. and international banking standards that may adversely impact the U.S. firms' ability to compete and economic growth. With respect to *H.R. 3746, the Business of Insurance Regulatory Reform Act*, FSR believes it is an important measure to clarify the authority of State insurance regulators on consumer protection. We urge you to move the bills forward.

Thank you for the opportunity to testify. I am happy to take any questions.