Statement of James C. Sivon
On behalf of
The Financial Services Roundtable
Before the
Subcommittee on Monetary Policy and Trade
And the
Subcommittee on Financial Institutions and Consumer Credit
Of the
Committee on Financial Services

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Chairman Barr and Ranking Member Moore, Chairman Luetkemeyer and Ranking Member Clay, my name is James Sivon, and I am appearing on behalf of the Financial Services Roundtable (FSR).[1] FSR is a national trade association for the nation's largest financial services companies. FSR members provide banking, insurance, payments, and investment products and services to consumers and businesses.

FSR appreciates the opportunity to address the Federal Reserve Board's (Board) role as a prudential regulator. FSR members recognize the need for regulations and supervisory policies that ensure stable financial markets and protect consumers. A decade ago, gaps in financial regulation and supervision contributed to a financial crisis and a national recession. Subsequent actions taken by Congress, financial regulators, and the financial services industry itself have restored the stability of the U.S. financial system. Today, large bank holding companies have more than doubled their capital from around $500 billion in 2009 to $1.2 trillion in the first quarter of 2017, and have more than doubled their risk-based capital ratios from 5.5 percent to 12.4 percent over that period.

[1] I am appearing in my capacity as an outside counsel to FSR. I am a partner in the law firm of Barnett Sivon & Natter, P.C., and a counsel with Squire Patton Boggs LLP.

The largest bank holding companies also have increased liquid assets from about $1.5 trillion to about $2.3 trillion between 2011 and the first quarter of 2017.[2]

Yet, experience has shown that some of the regulations and supervisory policies put in place in response to the financial crisis are holding back a more robust economic recovery. Loans to mortgage borrowers and small businesses illustrate this problem. The Urban Institute has estimated that over 5 million consumers were unable to obtain a mortgage loan between 2009 and 2014 because of a combination of new regulatory requirements and increased litigation risks faced by lenders and investors.[3] Other studies have found that since the financial crisis small businesses have suffered low rates of formation and tepid growth due, in part, to regulations that make it difficult for small businesses, especially those with limited credit histories, to obtain credit.[4]

A recent analysis of post-crisis lending by large bank holding companies supports these findings. That analysis, which was conducted by the economic research division of the Board, found that, while bank lending has been robust for the past three years, lending growth by more heavily regulated large banks (those with more than $50 billion in assets) lags lending growth by smaller banks.[5]

FSR believes that the goal of prudential regulation and supervision should be to promote both financial stability and economic growth. FSR appreciates the steps the Board already has taken to tailor some prudential standards and supervisory policies. Last year, for example, the Board revised the rules governing capital planning and stress testing for

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[2] Jerome H. Powell, Member Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs U.S. Senate, June 22, 2017.

[3] Bin Bai, Laurie Goodman and Jun Zhu, *Tight Credit Standards Prevented 5.2 Million Mortgages Between 2009 and 2014*, Urban Institute (Jan. 28, 2016).

[4] Federal Reserve Banks, 2016 Small Business Credit Survey, (Apr. 2017), https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf. *See also* Amanda Hindlian, Sandra Lawson, Katherine Maxwell, Koby Sadan, and Sonya Banerjee, *The Two Speed Economy*, Goldman Sachs Global Markets Institute (Apr. 2015).

[5] Cindy M. Vojtech, Post-Crisis Lending by Large Bank Holding Companies, FEDS Notes (July 6, 2017), https://www.federalreserve.gov/econres/notes/feds-notes/post-crisis-lending-by-large-bank-holding-companies-20170706.htm.

bank holding companies defined as "large, non-complex" institutions.[6] More recently, the Board has proposed changes in its supervisory policies related to boards of directors, and, in conjunction with the other federal banking agencies, the Board has proposed some refinements to the Basel III capital rules. However, more can be done to tailor existing regulations.

The first part of my testimony highlights several proposed reforms to existing prudential standards and supervisory policies that would enable FSR members to meet the financial needs of consumers and businesses while preserving financial stability. The proposed reforms are taken from a larger set of proposed reforms FSR recently submitted to the Treasury Department.[7] The second part of my testimony makes three general recommendations for financial regulatory reform.

I. FSR's Recommendations Related to Specific Regulations and Supervisory Policies Administered by the Board

The Dodd-Frank Act gave the Board authority to implement prudential standards for large bank holding companies and nonbank financial companies designated by the Financial Stability Oversight Council (FSOC) for supervision by the Board. My testimony addresses the standards related to: capital planning and stress testing; capital and liquidity requirements; resolution planning and recovery requirements; the prudential standards applicable to insurance companies supervised by the Board; model validation and vendor management guidance. It also addresses the Volcker Rule.

The Capital Planning and Stress Testing Rules Should be Adjusted

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[6] Under the Federal Reserve's Final Rule this includes institutions with average total consolidated assets between $50 billion and $250 billion and that have average total nonbank assets of less than $75 billion.
[7] That submission, which includes over 100 recommendations, was made in response to Executive Order 13772, which directed the Department to conduct an assessment of the extent to which the regulation of the U.S. financial system is consistent with a set of Core Principles set out in the Order. A copy of that submission may be found at the following Internet address: http://www.fsroundtable.org/wp-content/uploads/2017/06/FSR-Letter-to-Treasury-on-Core-Principles-May-3.pdf.

The comprehensive capital analysis review (CCAR) and stress testing rules are among the most impactful rules adopted since the crisis. Those rules have helped FSR members build stronger capital positions and address risk management weaknesses that contributed to the crisis. As time has passed, however, it is increasingly apparent that the rules can be adjusted without impairing their fundamental purpose.

The General Accountability Office (GAO) has recommended several adjustments to the capital planning and stress testing rules that are designed to increase the transparency of these rules.[8] As GAO noted in that report, transparency is a key feature of accountability and incomplete disclosure may limit understanding of the stress test results and hinder public and market confidence in the program. FSR supports many of the GAO's proposed reforms.

FSR also supports more disclosure regarding the modeling principles used in the Board's stress testing formulas and the full disclosure of the Board's supervisory models after a reasonable delay.[9] FSR members find significant disparities between their own internal evaluations of risk and the loss projections predicted by the models used by the Board. This creates a level of uncertainty around the process that can impact lending decisions. It leads companies to make assumptions about the Board's models and then adjust their loan portfolio to conform to those assumptions in order to meet their capital

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[8] GAO, *Additional Actions Could Help Ensure the Achievement of Stress Test Goals*, (Nov. 15, 2016). (The recommendations made in this report include the following: (1) The Board, FDIC, and OCC should harmonize their agencies' approach to granting extensions and exemptions from stress test requirements; (2) The Board should publicly disclose additional information that would allow for a better understanding of the methodology for completing qualitative assessments, such as the role of ratings and rankings and the extent to which they affect final determination decisions; (3) The Board should assess—and adjust as necessary—the overall level of severity of its severely adverse scenario by establishing a process to facilitate proactive consideration of levels of severity that may fall outside U.S. postwar historical experience, and expanding consideration of the trade-offs associated with different degrees of severity; (4) The Board should assess whether a single severe supervisory scenario is sufficient to inform CCAR decisions and promote the resilience of the banking system; (5) The Board should develop a process to test its proposed severely adverse scenario for pro-cyclicality annually before finalizing and publicly releasing the supervisory scenarios; and (6) The Board should improve management of model risk and ensure decisions based on supervisory stress test results are informed by an understanding of model risk.)

[9] Alternatively, the Federal Reserve could establish a process by which banks could meet individually with the Board's staff in Washington, D.C. to discuss concerns regarding the outputs of Federal Reserve models. At a minimum these discussions would allow banks to learn if discrepancies are being driven by specific model assumptions or because of specific model factors that are being used by the Federal Reserve.

requirements. More transparency surrounding the Board's models would reduce this uncertainty and help to ensure that the Board's CCAR practices do not discourage appropriate lending activities.

As I have noted, the Board recently revised the capital planning and stress testing rules for large, non-complex bank holding companies. Under the revised rules, the Board will assess a company's risk management practices as part of the Board's normal supervisory process, rather than in conjunction with the capital planning and stress testing process. In other words, the Board will not object to a company's capital plan based upon a company's compliance with "qualitative" standards. In proposing this change, the Board stated that it was designed to ensure that companies did not "over-invest in stress testing and capital planning processes that are unnecessary to adequately capture the risk of these firms."[10] FSR recommends that the Board expand this treatment to all bank holding companies, regardless of size, based upon the ongoing supervision that occurs onsite and offsite at these institutions.[11]

Additionally, capital planning and stress testing standards is an area where greater coordination between regulators is needed. While the Board has changed its policies regarding qualitative assessments, the Office of the Comptroller of the Currency (OCC) has retained enhanced documentation and disclosure standards that conflict with the Board's attempt to reduce the regulatory burden requirements entailed in the annual capital planning process. FSR recommends that the OCC modify its policies to be consistent with those adopted by the Board.

Finally, FSR recommends that the Board revise its rules governing capital distributions outside of the capital planning cycle. Under current rules, a company may make capital distributions outside of the capital planning cycle only if those distributions

[10] 81 Fed. Reg. 67241 (Sept. 30, 2016).
[11] Notably, the Board has recently proposed a new rating system for large institutions that will include a specific rating for capital planning obviating the need for a separate measure as part of the CCAR process. 82 Fed. Reg. 39049 (Aug. 17, 2017).

meet a de minimis standard or the company obtains special permission from the Board. If a company has successfully passed a stress test, FSR believes the company should have the ability to manage its own capital position and distribute excess capital in situations where its performance surpasses the projections embedded in its earlier capital plan.

Tailor the Capital Rules and Liquidity Rules

Recent stress test results show that bank holding companies subject to CCAR can withstand an economic downturn comparable to the financial crisis in 2007-2008.[12] These results indicate that we have reached a point where the capital and liquidity rules could be adjusted to promote economic growth, without jeopardizing financial stability. Toward that end, FSR recommends:

- Adjust the Supplemental Leverage Ratio – Banking regulators should revise the calculation of the supplementary leverage ratio to exclude risk-free assets from the calculation of a company's total assets for purposes of the ratio. This would include reserves held at the Federal Reserve, cash, and Treasury securities. This change would free funds to enable banks to offer products, such as derivatives clearing and securities financing agreements that both support financial stability and foster economic growth. The Bank of England recently exempted cash deposits held at the central bank from its calculation of the leverage ratio.[13] Similarly, FSR recommends that the Board eliminate the "enhanced" SLR requirement for the nation's largest banking organizations.[14] The current U.S. requirements double international standards and create a competitive disparity for U.S. banking organizations.

- Revise the Capital Surcharge – FSR recommends that the capital surcharge for the nation's largest banks be aligned with international standards. In implementing the

[12]https://www.federalreserve.gov/publications/files/2017-dfast-methodology-results-20170622.pdf.
[13] Bank of England, *Financial Policy Committee Statement from its Policy Committee Meeting* (July 25, 2016), http://www.bankofengland.co.uk/publications/Documents/news/2016/062.pdf.
[14] The enhanced SLR requires these companies to meet a 5% SLR at the holding company level and a 6% SLR at the bank level. The standard included in Basel III is 3%.

capital surcharge for U.S. banking organizations, the Board adopted an additional requirement (called "method 2") for the nation's largest bank holding companies that imposes a surcharge beyond the international standard. The internationally accepted G-SIB surcharge framework produces a risk score derived from a firm's attributes in five categories: size, interconnectedness, complexity, cross jurisdictional activity, and substitutability. Method 2 replaces the substitutability category with a measure of a firm's reliance on short-term wholesale funding. While FSR appreciates the risks associated with overdependence on short-term wholesale funding, these risks are already accounted for in the 30-day liquidity coverage ratio, new rules requiring the issuance of minimum levels of unsecured debt, and the Dodd-Frank Act enhanced prudential standards 30-day liquidity stress test. This change would help large U.S. bank holding companies remain competitive with foreign firms in domestic and foreign markets.

- Expand the Scope of High-Quality Liquid Assets (HQLA) under the Liquidity Rule – FSR recommends that the Board (and other federal banking agencies) adjust the treatment of mortgage securities, municipal securities, FHLB obligations, and securities issued by governments sponsored entities (GSEs) such as Fannie Mae and Freddie Mac in the liquidity coverage ratio (LCR). The LCR requires a banking organization to hold enough high quality assets to cover a net outflow of cash over a 30 day period. The final rule defines three categories of high quality assets, level 1, level 2A and level 2B. Level 2A and 2B assets are subject to haircuts of 15 and 50 percent respectively. Currently, however, most municipal securities and private mortgage backed securities are not treated as high quality liquid assets, and FHLB and GSE obligations are treated as level 2A assets, subject to a 15 percent haircut. This is despite the fact that there are highly-liquid markets for each of these obligations, and including them in the category of high quality liquid assets would reduce reliance on Treasury securities.

- Revise the Outflow Assumptions in the Liquidity Rule – FSR recommends that the Board (and other federal banking agencies) revise the run-off assumptions in the LCR. The calculation of net cash outflows under the LCR rule is overly conservative and should be aligned with the international LCR requirements or be adjusted to better match the conditions experienced by failing banks in the most recent financial crisis. Appropriate changes include: (1) eliminating the maturity mismatch add-on component of the U.S. LCR calculation and instead use cumulative net cash outflow amounts over the 30-day assumed stress period to address maturity mismatches; 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 cash outflow rates and assumptions. For example, the final U.S. LCR rules provide for 0% liquidity value for non-operating deposits and excess operational deposits of financial institutions. This assumption does not take into account the wide range of regulated financial companies and observed historical behaviors during times of stress.

Coordinate Resolution and Recovery Planning Requirements

Resolution planning has helped FSR members rationalize operations and contracts and put in place plans to respond to financial distress. Yet, this requirement, combined with separate recovery planning requirements, is an area where greater coordination among the agencies is needed.

The Dodd-Frank Act requires all bank holding companies with more than $50 billion in assets to submit periodic resolution plans to the Board and the Federal Deposit Insurance Corporation (FDIC). Using its general authority to issue regulations under the Federal Deposit Insurance Act, the FDIC has issued a companion rule that requires insured banks with more than $50 billion in assets to submit annual resolution plans. [15] The Board and the OCC separately have also required institutions under their supervision to develop

[15] *Resolution Plans Required for Insured Depository Institutions with $50 Billion or More in Total Assets*, Fed. Reg. 3075 (Jan. 23, 2012) (codified at 12 C.F.R. pt. 360).

recovery plans that map actions the company may take to remain a going concern when experiencing financial or operational distress.[16] FSR recommends that the Board, FDIC and OCC align these requirements so materials developed for one purpose could be incorporated by reference into other filings.

FSR also recommends that the reporting cycle for resolution plans required under the Dodd-Frank Act and the FDIC's rule for insured depository institutions be moved to a two-year cycle rather than annually. This step could be taken at the sole discretion of the Board in tandem with the FDIC. It is increasingly evident that these annual requirements are neither efficient nor effective for both regulators and covered firms. For firms, resolution plans do not change substantially from year to year, absent a material change in a firm's structure. Regulators, in turn, have been hard pressed to provide feedback on plans under the current annual cycle.

Tailor Prudential Standards for Insurance Companies

As a result of the Dodd-Frank Act, the Board gained regulatory and supervisory authority over insurance companies that operate as savings and loan holding companies (SHLCs) as well as insurance companies designated by FSOC for supervision by the Board. While the Board has indicated a willingness to consider the unique characteristics of the business of insurance through tailored rulemaking, FSR believes the Board could be more attentive to the differences between the business of insurance and banking.

For example, in 2011, shortly after it assumed authority for SHLCs, the Board indicated that it would supervise SLHCs in a manner consistent with its approach to supervising bank holding companies while taking into account any unique characteristics of SLHCs.[17] Since then, however, the Board has issued numerous supervisory letters

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[16] The Board's rules apply to the nation's largest eight bank holding companies, and the OCC's rules apply to all national banks with more than $50 billion in assets.
[17] Federal Reserve, *SR 11-11: Supervision of Savings and Loan Holding Companies* (July 21, 2011), https://www.federalreserve.gov/supervisionreg/srletters/sr1111.pdf.

applicable to SLHCs that do not specifically address how they should be applied to SLHCs with substantial insurance operations.[18] Such guidance should be better tailored to insurance SLHCs.

Additionally, last year, the Board invited comment on two different capital standards for the insurance companies it regulates: a "building block" approach (BBA) for insurance companies that are SHLCs and a "consolidated" approach (CA) for the insurance companies that have been designated by FSOC for supervision by the Board. FSR believes the BBA should be applied to all insurers supervised by the Board, not just SHLCs. The BBA-based framework offers a uniform and effective approach that effectively accounts for the various activities and risks of the different legal entities within a covered insurance group. It leverages existing standards that have already been vetted, tailored, and calibrated to the business of insurance by state insurance authorities. It also minimizes any disparate impacts that could arise from pursuing different approaches to capital for different types of insurance companies.

Review Model Validation and Vendor Management Standards

During the past several years, the Board (and other federal banking agencies) has increased supervisory attention on model validation[19] and vendor management.[20] FSR appreciates that these practices deserve supervisory oversight, since both impact an

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[18] SR 14-9 extended nearly 120 prior SR letters to SLHCs without any differentiation for insurance companies that are SLHCs. Federal Reserve, SR 14-9: Incorporation of Federal Reserve Policies into the Saving and Loan Holding Company Supervision Program (Nov. 7, 2014), https://www.federalreserve.gov/supervisionreg/srletters/sr1409.pdf

[19] *See* Federal Reserve, *SR 11-7: Supervisory Guidance on Model Risk Management* (Apr. 4, 2011), https://www.federalreserve.gov/bankinforeg/srletters/sr1107.htm

[20] *See* OCC, *Risk Management Guidance, OCC Bulletin 2013-29* (Oct. 30, 2103), http://www.occ.treas.gov/news-issuances/bulletins/2013/bulletin-2013- 29.html; Federal Reserve, *Board Supervisory Letter 13-19 and Guidance on Managing Outsourcing Risk* (Dec. 5, 2013), https://www.federalreserve.gov/bankinforeg/srletters/sr1319a1.pdf; FDIC, *Guidance For Managing Third-Party Risk*, Financial Institutions Letter 44-2008 (2008),https://www.fdic.gov/news/news/financial/2008/fil08044a.html; NCUA, *Evaluating Third Party Relationships*, NCUA Supervisory Letter 07-01 (Oct. 2007) https://www.ncua.gov/resources/documents/lcu2007-13enc.pdf and FFIEC, *Handbook on Outsourcing Technology Services*, http://ithandbook.ffiec.gov/it-booklets/outsourcing-technology-services.aspx.

organization's operations, and potentially its reputation. However, in both cases, we believe that it is time to reassess existing standards and requirements.

Model validation should be limited to models that have a material impact on an organization. Current guidance, however, often requires firms to justify and validate non-critical analysis tools or develop and monitor models for activities that are highly subjective, such as BSA/AML compliance. [21] Notably, this guidance is in tension with other supervisory letters directing banks to establish risk management processes that are tailored to their individual needs.[22] To remedy this conflict, FSR recommends that the Board and OCC revise their current supervisory guidance related to model risk.

Similarly, vendor management requirements are inadvertently causing firms to only rely on larger vendors, resulting in an increasing concentration of vendor risk. FSR recommends that the Board (and other federal banking agencies) review current guidance to provide some flexibility for financial institutions to engage with vendors that undergo due diligence and are deemed not risky to the institution's customers.[23]

Revisit the Volcker Rule

FSR recommends that the federal financial regulators revisit the Volcker Rule. During the comment period on the Volcker Rule, many commenters asserted that the Rule would impair liquidity in the nation's capital markets. That concern since has been documented in an analysis of liquidity in the corporate debt markets conducted by

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[21] SR 11-7. Federal Reserve Supervisory Assessment of Capital Planning and Positions for Large and Noncomplex Firms (Dec. 18, 2015), https://www.federalreserve.gov/supervisionreg/srletters/ sr1519_PW.pdf.
[22] See, Federal Reserve, SR 15-19
[23] OCC Bulletin 2013-29 (http://www.occ.treas.gov/news-issuances/bulletins/2013/bulletin-2013-29.html); FRB Supervisory Letter 13-19 and Guidance on Managing Outsourcing Risk (https://www.federalreserve.gov/bankinforeg/srletters/sr1319a1.pdf); FDIC Financial Institutions Letter 44-2008 (https://www.fdic.gov/news/news/financial/2008/fil08044a.html); NCUA Supervisory Letter 07-01 (https://www.ncua.gov/resources/documents/lcu2007-13enc.pdf); and FFIEC Handbook on Outsourcing Technology Services (http://ithandbook.ffiec.gov/it-booklets/outsourcing-technology-services.aspx).

economists at the Board.[24] Additionally, several Governors on the Federal Reserve Board have acknowledged that the Rule is overly complex and should be reviewed.[25]

As part of a review of the Volcker Rule, FSR recommends that:

- The Rule be tailored by exempting institutions that score below a certain threshold on the "complexity" and "interconnectedness" indicators within the systemic indicator framework;

- The scope of the covered fund prohibitions in the Rule be amended or reinterpreted to limit the definition of covered fund only to Section 3(c)(1) or Section 3(c)(7) funds that engage in prohibited proprietary trading. This would achieve the goal of prohibiting indirect, impermissible proprietary trading through investment in a covered fund and limiting banking entities from bailing out sponsored covered funds, while preserving safety and soundness and without sweeping in core asset management, ordinary corporate structures, securitizations and related activities that were not meant to be restricted by the Volcker Rule;

- The prohibition on proprietary trading be adjusted not to reach client-oriented activities. The Rule does not clearly define proprietary trading, and such ambiguity forced dealers toward more conservative trading strategies, leading to less liquid markets. For example, the current prohibition captures certain asset-liability management activities and Treasury functions. To address this, we recommend that

[24] Jack Bao, Maureen O'Hara, and Alex Zhou, *The Volcker Rule and Market-Making in Times of Stress*, Financial and Economics Discussion Series (2016).
[25] See, Departing Thoughts, Remarks by Daniel K. Tarullo, Member Board of Governors of the Federal Reserve System at The Woodrow Wilson School Princeton University Princeton, New Jersey April 4, 2017, ("….several years of experience have convinced me that there is merit in the contention of many firms that, as it has been drafted and implemented, the Volcker rule is too complicated.") See also, Remarks by Jerome H. Powell, Member Board of Governors of the Federal Reserve System, Salzburg Global Seminar Salzburg, Austria June 26, 2017 ("In our view, there is room for eliminating or relaxing aspects of the implementing regulation in ways that do not undermine the Volcker rule's main policy goals.")

the prohibition be revised to focus on trading activities that are wholly unrelated to financial intermediation, risk management, or asset/liability management;

- The agencies should reverse the presumption in the Volcker Rule's regulation of short-term trading. The regulation currently presumes that a position held for 60 days or less *is* proprietary trading. Instead, any security or derivative held longer than 60 days should be presumed *not* to be proprietary trading (i.e., not in a Volcker trading account under the Rule). Further, any security or derivative not held in a broker-dealer or swap dealer desk, or not subject to market risk capital rules (or their equivalent under applicable regulations), should be presumed to be excluded from a Volcker trading account; and

- Banking institutions with assets of $50 billion or more not be required automatically to meet standards for "enhanced compliance programs." While these safeguards may be appropriate for some firms, the use of an arbitrary asset-based threshold does not distinguish between companies with extensive trading portfolios and covered activities and those with simple investment activities used solely for traditional asset liability management. The regulators should amend the Rule to replace the $50 billion asset threshold with a threshold that accounts for a company's activities and risk profile.

II. FSR's General Recommendations

In addition to the foregoing recommendations, FSR has three general recommendations for aligning financial regulations and supervisory policies with economic growth. These recommendations apply broadly to all federal financial regulatory agencies. They are: (1) to base prudential standards on an assessment of risk rather than the size of an institution; (2) to improve policy coordination among all federal financial regulatory agencies; and (3) to conduct an assessment of the impact of the Current Expected Credit Loss (CECL) accounting standard on lending and economic growth.

Prudential Standards should be Based upon an Assessment of an Institution's Risk, Not Size

Currently, many of the prudential regulations imposed on financial firms are based upon the size of an institution, not the risk it may pose to financial stability. For example, heightened prudential standards apply to all bank holding companies with more than $50 billion in assets and all nonbank financial companies designated by the FSOC for supervision by the Federal Reserve Board (Board); stress tests apply to any bank holding company with more than $10 billion in assets; and the federal banking agencies have established other supervisory standards based upon a $250 billion threshold that was incorporated in the Basel capital framework over a decade ago.

Such fixed dollar thresholds result in "cliff" effects for institutions near the thresholds. These effects cause institutions to take actions simply designed to avoid the thresholds, including not undertaking new business opportunities that could contribute to economic growth. Similarly, institutions that cross a threshold suddenly find themselves in a new supervisory category that carries substantial compliance costs, even though their risk profile has not changed.

To overcome these problems, FSR recommends that prudential standards be based upon an assessment of the risk posed by the operations and activities of a company, not just a company's asset size.[26] Asset size could be used as a factor in such an assessment, but should not be the determinative factor.[27] Regulators could also develop an approach under which a company that crosses an asset threshold is subject to a risk analysis to determine whether the company should be subject to a particular prudential standard. This approach also would allow regulators to impose prudential standards on institutions that may be below an asset threshold but pose some risk based upon their mix of activities.

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[26] Making these changes requires a combination of actions by Congress and federal regulators. Several of the current asset thresholds were established in the Dodd-Frank Act. Others, such as the $250 billion threshold, have been set by the federal banking agencies under their general regulatory authority and can be changed under the same process.

[27] We note that information on a variety of systemic risk indicators, which could be used for such a calculation, is already provided to the Federal Reserve via the FR-Y 15 form.

FSR is not alone in calling for prudential standards to be based upon risk rather than size. It is now widely accepted that risk-based criteria provide a better measure of risk than an exclusive reliance on asset size.[28] Think tanks [29] and even members of the Board[30] have called for either raising asset thresholds or replacing them with a risk assessment. FSR further supports the bipartisan framework set out in H.R. 3312, the "Systemic Risk Designation Improvement Act of 2017." We thank Chairman Luetkemeyer and other committee members for their work on this issue and pledge our support to your continued efforts in this area.

Greater Coordination Among Federal Financial Regulatory Agencies is Needed

FSR members are subject to regulation and supervision by multiple federal regulatory agencies. While each of these agencies has its own statutory mission, those missions can overlap and conflict. This results in a misallocation of resources by regulators and regulated firms, and increases the cost of financial products and services to consumers and businesses. Greater coordination among federal financial regulators would help to make financial regulation more predictable, reduce regulatory gaps, and minimize regulatory conflict that can impair economic growth.

Some of the regulatory and supervisory policies addressed in this statement illustrate this overlap and conflict. Other areas where greater coordination is needed include examination practices, reporting requirements,[31] and cybersecurity standards.

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[28] Aite Group, *Bank Size vs. Systemic Importance* (Oct. 2015), http://www.fsroundtable.org/wp-content/uploads/2015/10/Bank-Size-vs-Systemic-Importance_Aite-Group-Study_FINAL_October-19-2015.pdf.

[29] Bipartisan Policy Center, Dodd-Frank's Missed Opportunity: A Road Map for a More Effective Regulatory Architecture (Apr. 2014), https://bipartisanpolicy.org/library/dodd-franks-missed-opportunity-road-map-more-effective-regulatory-architecture-2/.

[30] Departing Thoughts, Remarks by Daniel K. Tarullo, Member Board of Governors of the Federal Reserve System at The Woodrow Wilson School Princeton University Princeton, New Jersey April 4, 2017, ("… I have said for several years now, we have found that the $50 billion in assets threshold established in the Dodd-Frank Act for banks to be "systemically important," and thus subject to a range of stricter regulations, was set too low. Similarly, the $10 billion asset threshold for banks to conduct their own required stress tests seems too low.")

[31] FSR has submitted a letter to the Office of Financial Research cataloging some of the overlap in existing

Enhancing coordination among federal financial regulators does not require a wholesale restructuring of those agencies. Federal financial regulators have the ability to coordinate policies and practices, but lack a clear directive to do so. This problem could be resolved through the enactment of a statutory set of guiding principles for federal financial regulators. Once embodied in law, these principles would serve as a touchstone against which all future financial regulations and supervisory practices could be evaluated. Statutory guiding principles encourage federal financial regulators to coordinate policies and practices without diminishing their independent missions. The Core Principles in Executive Order 13772 could serve as a model for statutory principles.

FSOC also is positioned to facilitate greater policy coordination among federal financial regulators. Absent the enactment of a set of guiding principles for financial regulation and supervision, FSR urges the Committee to use the required annual hearing on the FSOC's activities to promote regulatory and supervisory coordination among the members of FSOC.

The Impact of CECL on Lending Should Be Evaluated

The Financial Accounting Standards Board (FASB) has finalized an accounting standard that fundamentally alters the manner in which banks must reserve for loan losses. Rather than establishing a reserve when a loss is likely to be incurred, the Current Expected Credit Loss, or CECL standard, requires banks to estimate expected losses when a loan is made.

This change is intended to increase financial stability and improve liquidity throughout economic cycles. However, FSR members are concerned that the new standard

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reporting requirements for large banking organizations. Letter to Richard Berner, Director of the Office of Financial Research from the Financial Services Roundtable (Mar. 22, 2017), http://www.fsroundtable.org/wp-content/uploads/2017/09/FSR_SUBMISSION_TO_OFR_ON_DUPLICATIVE_DATA_REQUESTS.v3.0.final_.pdf.

could reduce lending in recessionary periods (i.e., be pro-cyclical), and generally reduce lending to certain types of loans, such as mortgage loans and small business loans. An earlier analysis of the impact of the new standard performed by the Office of the Comptroller of the Currency (OCC) estimated that CECL would require national banks to increase loss reserves by as much as 30% to 50% over current levels.[32]

The implementation of CECL presents immense operational challenges. In setting a loss reserve an institution must take into consideration economic conditions not only when the loan is made, but throughout the entire term of the loan. Thus, CECL is premised on an institution's ability to accurately forecast future economic conditions over a period of decades. Making such forecasts can be challenging and could greatly impact the availability of long-term lending products such as a 30-year mortgage.

The CECL standard is scheduled to be effective for public companies, including bank holding companies, starting December 2019, and for other companies starting in December 2020. Before this standard goes into effect, FSR recommends policymakers conduct a comprehensive assessment of its potential impact on lending and economic growth. This assessment should include an evaluation of the relationship between loan loss reserves and capital requirements. In other words, if CECL goes into effect as proposed, consideration should be given to counting an institution's loss reserve as part of its common equity Tier 1 capital, since both are designed to enable an institution to continue to operate throughout economic cycles.[33]

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[32] Curry, Thomas J. "Remarks by Thomas J. Curry, Comptroller of the Currency, Before the AICPA Banking Conference, Washington, D.C." September 16, 2013.

[33] The FDIC's Risk Management Examination Manual states that one of the fundamental purposes of capital is to enable an institution to continue operating as going concerns during periods when operating losses or other adverse financial results are experienced. (https://www.fdic.gov/regulations/safety/manual/section2-1.pdf.) The Financial Accounting Standards Board similarly states that CECL will enable an institution to operate in all economic conditions: "The new standard requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts."
(http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176168232790.)

III. Conclusion

Thank you again for the opportunity to address the Federal Reserve Board's role as a prudential regulator. I would be pleased to answer any questions.