



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DANIEL K. TARULLO
MEMBER OF THE BOARD

March 21, 2017

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

As you know, the Federal Financial Institutions Examinations Council (FFIEC) has just submitted to Congress a report on its second review of banking regulations conducted in accordance with the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). By its nature, EGRPRA tends to elicit comments on specific regulations, or parts of regulations and, in turn, to prompt responses from the banking agencies addressing these specifics. Valuable as this process can be, it can result in attention being focused mostly on the particulars of the regulatory system, rather than on the basics. Because my two-year statutory term as Chair of FFIEC is ending and, indeed, I will soon be resigning from the Board of Governors, I wanted to take this opportunity to offer, on a personal basis, some more general observations.

The EGRPRA review has coincided with a period in which many regulatory changes following the financial crisis continue to be implemented. Although it may be a bit early to judge the efficacy of some new regulations in counteracting potential sources of serious financial instability, particularly with respect to their application to larger and more complex institutions, most of the comments received during the EGRPRA process came from smaller banks or entities representing smaller banks. These comments covered both some post-crisis regulations and some longer-standing ones. Here, precisely because community banks were not at the source of the problems that led to the financial crisis, it has been easier to identify areas in which the burden associated with certain regulations seems incommensurate with any incremental gains to safety and soundness.

As detailed in the EGRPRA report, the FFIEC has considered, and responded to, the subject areas that were most frequently cited in the comments of smaller banks and are within the jurisdiction of the FFIEC member agencies to change – including capital requirements, regulatory reporting, appraisals, and examination frequency. In some cases, changes have

already been made. In others, changes have been proposed or are being developed. I would supplement the report with two broader points.

First, the EGRPRA review process has reinforced my view that quite different regulatory configurations should apply to banks of different sizes and activities, which pose quite different risks to the financial system. In part, this goal can be achieved through a well-considered tiering of regulatory requirements. The Dodd-Frank Act makes a good start in recognizing this principle but, at least in my view, some of the dollar asset thresholds it establishes for application of a particular regulation are unnecessarily high. Thus, as I have previously suggested, the thresholds for application of new regulations such as the Volcker Rule and incentive compensation guidelines should be raised so as to exclude community banks. Similarly, I continue to believe that the threshold for application of the enhanced prudential standards required by section 165 of Dodd-Frank should be raised above the current \$50 billion level. I am also sympathetic to the argument offered by some smaller regional banks with between \$10 and \$50 billion in assets that they should be excluded from all stress testing requirements.

In addition, there are some core forms of prudential regulation that ought to be conceived of differently for different tiers of banks. Foremost among these are capital requirements. There are very good reasons why the nation's largest banks should be subject to strong leverage ratio requirements and fairly detailed risk-based capital requirements, both supported by a robust supervisory stress testing system. Serious stress or failure of these banks could sharply limit credit availability or even threaten financial stability. At the other end of the spectrum lie community banks, whose balance sheets are usually relatively straightforward and whose impact on the financial system as a whole is quite limited. The rules applicable to these banks should not only be tiered so as to exclude stress testing, but should be conceived of quite differently from the capital standards applicable to medium-sized and larger banks. The changes proposed in the EGRPRA report might usefully be regarded as a kind of down payment on what I hope will ultimately be substantially simpler capital rules applicable only to community banks. While there is more scope for concerted action towards this end among the federal banking agencies, some statutory changes may be needed to enable an optimally tailored community bank capital regime.

Second, it became clear to me while listening to community bankers in our advisory committees and in the EGRPRA process that examination and supervisory processes can be as much or more costly for these banks as the underlying regulations themselves. Sometimes it takes smaller banks a good deal of work just to confirm that a regulation does not apply to its activities. Moreover, while larger institutions have dedicated, specialized personnel to deal with on-site examinations and regulatory reporting, most community banks cannot reasonably afford to employ more than a small number of employees to cover all compliance requirements. Accordingly, senior management must often be closely involved in dealing with on-site examinations and responding to routine supervisory concerns. This is an undesirable outcome from the standpoint both of these banks and the communities they serve.

The Honorable Mike Crapo
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In closing, I believe the initiatives described in the EGRPRA report are useful steps along a path to a prudential regime that better matches the risks of various types of banks with applicable rules and oversight. However, a broader effort to tier banking regulation and a complementary project to address supervisory processes for community banks are necessary further steps in pursuit of this goal.

Sincerely,

A handwritten signature in black ink, reading "Daniel K. Jarrett". The signature is written in a cursive style with a large initial "D".



BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DANIEL K. TARULLO
MEMBER OF THE BOARD

March 21, 2017

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Brown:

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Sincerely,

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DANIEL K. TARULLO
MEMBER OF THE BOARD

March 21, 2017

The Honorable Jeb Hensarling
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

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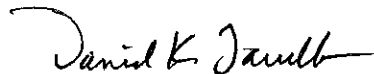
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DANIEL K. TARULLO
MEMBER OF THE BOARD

March 21, 2017

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

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The Honorable Maxine Waters
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Sincerely,

A handwritten signature in black ink, appearing to read "Daniel K. Jamb". The signature is written in a cursive, flowing style with a long horizontal stroke at the end.