February 6, 2024

The Honorable Neel Kashkari
President and CEO
Federal Reserve Bank of Minneapolis
90 Hennepin Avenue
Minneapolis, MN 55401

Dear President Kashkari,

We represent the state bankers associations from the states that are fully or partly in the Ninth Federal Reserve District. Our member banks collectively do an excellent job of serving their customers and their communities. The purpose of this letter is to share some perspectives from our member banks.

First, we want to convey that we are gravely concerned about the Federal Reserve Board's decision to undertake rulemaking on Regulation II, which implements the Durbin Amendment. That proposed regulation will have a significant negative impact on banks with more than $10 billion in assets. However, it will negatively impact smaller banks, too, as we clearly saw when the original Regulation II rulemaking took effect.

Second, we want to share that the cumulative effect of all the recent proposed and final rules will create significant challenges for banks of all sizes. These changes are simply too much, too fast.

Finally, we want to note some concerns that specifically impact community banks.

The banks we represent have gone through a lifetime of trials and tribulations in the last four years. They have dealt with challenges in virtually every aspect of banking. A lot of bankers are worn out, frustrated and looking forward to some average, boring economic times. They would also appreciate a regulatory environment that is stable and transparent.

Unfortunately, the economy will continue to pose some challenges in this new year. Of greater concern, the bank regulatory agencies are giving the banks the exact opposite of a stable and transparent regulatory experience.

1. **Massive Regulatory Changes on the Way**

The regulators have been extremely active, issuing several significant new proposed and final rules. Absorbing each of these regulatory issues, individually, will be challenging. Absorbing all these regulatory changes at once will cause a major problem for the banks, at an already challenging time.

Community Reinvestment Act (CRA) Revisions—All banks will need to digest the new CRA changes. The compliance date being two years out helps a lot. Our initial reading of the 1,480 pages of regulations suggests that they will be more data driven and formulaic. Banks preparing

for CRA exams will need to spend more time and resources proving they are serving their communities. Ironically, when banks spend more time and resources on proving they are in compliance with CRA, they have less resources available to actually serve their communities.

Basel III Endgame Capital Rules—Having appropriate balance in capital standards is important. Failing to require enough capital leaves banks at risk, but requiring too much capital will reduce the availability of credit. Risk-weighting certain assets will make that type of credit more expensive and/or less available. For example, requiring more capital for loans to privately held businesses than for publicly traded companies will impact the cost and availability of credit to privately held businesses. The vast majority of businesses are privately held, and many of them have excellent credit profiles. Assuming all the privately held businesses are, by definition, riskier than the publicly traded companies seems arbitrary. Similarly, holding more capital for mortgage loans that have a higher loan-to-value ratio will impact the banks' ability to make affordable credit available to low- and moderate-income homebuyers.

Federal Reserve Proposed Changes to Regulation II—The Durbin amendment is one of the worst examples of government-mandated price fixing. It should cause free market advocates to cringe. Retailers want and need the safety, security, and speed of the card system that banks created and maintain. They just don't want to pay for it. They also want to continue avoiding liability for card fraud. The Federal Reserve has issued a proposed rule to dramatically decrease debit card interchange fees that banks will receive. The Durbin Amendment was only supposed to impact banks over $10 billion in assets, but in practice it impacted all banks. The timing for this reduction in revenue could not be worse.

Importantly, this proposal will negatively impact the banks' revenues. Banks will likely change their account pricing to reflect the lost revenue, meaning consumers will pay more for banking services. The regulatory changes will provide a windfall for retailers. History has shown that retailers will pocket that money, without reducing costs to consumers. It makes an already bad public policy situation even worse.

2. New Consumer Compliance Challenges

Bankers work in a heavily regulated industry, and they understand that fact. The banks spend a lot of time and resources ensuring they comply with all applicable laws and regulations. When the banking rules are clearly defined, and the banks have time to implement new requirements, the banks have an excellent compliance record. Compliance becomes much more challenging when the regulators fail to follow the rules that govern their operations.

Currently, the banking regulatory agencies are ignoring basic Administrative Law principles. Congress passed the Administrative Procedure Act (APA) in 1946. Recognizing way back then that the federal regulatory agencies had a lot of power and authority over their regulated entities, Congress wanted to ensure that the agencies used that authority in a fair and transparent way.

Today's regulatory agencies are much larger, and they have much more power than they did in 1946. Therefore, the APA is more important now than ever before. In addition to setting standards to which the agencies must adhere, the law includes specific statutory claims that

regulated entities, and their representatives, can make when an agency does not follow the law. Exceeding statutory authority, acting in an arbitrary and capricious manner, and failing to follow the proper APA procedures are the most common of these statutory claims. Suing a federal agency for regulatory overreach is no small task, but sometimes regulated entities and their representatives have no other recourse. Sadly, banking trade groups have been forced to file a number of these lawsuits on behalf of their member banks.

Lawsuit Against the CFPB For its UDAAP Manual Changes—The CFPB announced a significant new regulatory change through a press release and a revision to one of its examination procedures manuals. The agency said that all forms of discrimination are automatically unfair, and revisions to its UDAAP Examination Procedures Manual directed CFPB examiners to look for discrimination in all aspects of banking. The CFPB gave its regulated entities no advance warning of this new regulatory position, and the agency intended to apply the new regulatory requirements retroactively.

This major change caught the banks off guard. The American Bankers Association, the Texas Bankers Association (ABA), and several other groups challenged the CFPB's action by claiming that the CFPB exceeded its statutory authority by making this regulatory change. They also claimed that the CFPB had essentially issued a new regulation, but the agency failed to follow the APA notice and comment procedures to do so.

The CFPB answered the complaint by filing a motion to dismiss the suit. The Judge in the case denied the CFPB's motion to dismiss. At the same time, the Judge issued a strongly worded declaratory judgment in favor of the plaintiffs because the CFPB had in fact violated the APA by exceeding its statutory authority. The court prevented the CFPB from enforcing this new, unlawful set of regulatory requirements.

Lawsuit Against the CFPB Regarding Its 1071 Regulation—The CFPB issued a regulation to implement the Dodd Frank Section 1071 data collection requirements. The CFPB turned two and a half pages of statutory language into an 800-page regulation. While the law required just 13 data fields, the CFPB regulation required a whopping 81 data fields. The Texas Bankers Association and the ABA filed suit against the CFPB challenging the 1071 rule on several grounds, including the fact that a Texas Court had found that the CFPB is structured unconstitutionally, and that the agency exceeded its statutory authority when it issued the regulation.

This case will test whether the CFPB implemented the law or whether they attempted to unlawfully expand the law. Congress has weighed in on this matter. Both the House and the Senate passed a bipartisan joint resolution to rescind the CFPB rule because it so drastically exceeded the scope of the Congressional mandate. Unfortunately for the banks, President Biden chose to veto the joint resolution so it will not take effect. Nonetheless, the bankers are grateful for this strong Congressional statement.

Lawsuit Against the FDIC Regarding Its Re-Presented Checks Rule— The FDIC issued a guidance document requiring banks to amend their deposit account agreements and declaring that a certain fact pattern violates the "Deceptive" portion of the Unfair or Deceptive Acts or

Practices (UDAP) Act. Most banks used Model Regulation DD disclosures that were acceptable for years, but suddenly they became a major compliance problem. The FDIC compliance examiners vigorously enforced this new standard retroactively.

The Minnesota Bankers Association filed a lawsuit against the FDIC claiming its regulatory position on re-presented checks violated the APA in several ways. The suit alleges that the FDIC did not have authority to amend the Regulation DD disclosure requirements because only the CFPB has that authority. It also states that, even if the FDIC did have proper authority, the lawful way to amend an existing regulation is by going through the full, notice and comment regulatory process, not by issuing a guidance document.

Further, the suit alleged that the FDIC does not have authority to define, with specificity, the types of actions that violate UDAP. The UDAP statute gives the Federal Trade Commission (FTC) that authority, not the FDIC or the other prudential banking regulatory agencies. The statute further states that the way the FTC must exercise that authority is by issuing a full regulation, not through a guidance document.

The FDIC responded to the complaint by filing a motion to dismiss the suit. The hearing on that motion to dismiss is scheduled for March 13th.

Lawsuit Against the Federal Reserve, FDIC and OCC Regarding Their CRA Rules—Late yesterday, the ABA, US Chamber of Commerce, TBA, and several other plaintiffs sued the three federal banking agencies regarding the CRA rules discussed above. The lawsuit makes several APA claims, including that the agencies exceeded their statutory authority in issuing this massive rule. We have not fully digested all the claims, as this latest lawsuit is late breaking news.

We would like to say that these four examples of regulatory overreach are the only ones our member banks are facing. However, there are at least another ten actions by various bank regulators that likely violate the APA. The bank regulatory agencies' failure to treat banks in a fair and transparent manner is beyond disappointing.

Many of the new compliance issues banks face are CFPB UDAAP-related regulatory actions. Instead of using the full notice and comment rulemaking process to issue a regulation that has the force and effect of law, the CFPB is issuing guidance documents. Then, the CFPB is improperly enforcing these new requirements against banks with over $10 billion in assets, which is just plain wrong. In some cases, the other bank regulatory agencies are enforcing these new requirements against their banks under that size limit, which is equally wrong.

We understand that the CFPB is charged with protecting consumers, but we believe that the CFPB's actions go farther than they should. Specifically, the CFPB is appears to be creating a system where consumers no longer have responsibility or accountability for their own actions. That scenario is disturbing.

3. Community Banks Stretched Thin

The Ninth Federal Reserve District is home to many community banks, and they continue to be stressed as compliance, regulatory and technology costs rise. We worry that increasing these

fixed costs, while also decreasing revenue opportunities, will continue to drive community bank mergers and acquisitions.

For many years, the community banks argued that policy makers did not understand their unique business model. Banking advocates urged Congress to mandate that someone with community banking experience should hold one of the seats on the Federal Reserve Board to ensure this constituency's interests are represented. Congress eventually agreed, requiring that a person with that type of experience must hold one of the seats on the Board. We are so grateful that Governor Michelle Bowman is serving in that role. Her experience is perfect for that spot, and she does a great job of articulating the views of community bankers.

For example, Governor Bowman voted against the proposed rule to decrease debit card interchange fees. At its recent meeting, the members of the Federal Reserve's Community Depository Institutions Council voted to recommend that the Federal Reserve Board withdraw its Regulation II proposal to decrease fees, for many of the same reasons Governor Bowman cited.

Governor Bowman recently gave a speech that included three regulatory "New Years Resolutions" for the Federal Reserve Board in 2024. That speech was fantastic, and we echo her desire for prioritizing safety and soundness supervision, a renewed emphasis on the Congressionally mandated tailoring of regulations so they fit the different bank business models and increasing regulatory transparency. We strongly support those three resolutions, and we hope the Federal Reserve Board takes them to heart.

Too many times, the Federal Reserve Board ignores Governor Bowman's suggestions and ideas, especially those concerning the impact that regulatory policies will have on community banks. We fought for a long time to get a community bank voice on the Board. Now, that community banks have a seat at the table, we need the Board to listen to and support their voice. It would be great if Governor Bowman's opinions and suggestions were incorporated into the Federal Reserve Board's policies, rather than just being noted as dissenting votes.

We tried to convey these messages concisely. However, because we had a lot to say, this letter has gotten very long. Thank you very much for your attention to our comments and concerns. If you would like to discuss anything in this letter further, we would welcome that opportunity.

Thank you, too, for your service to the Minneapolis Federal Reserve Bank, and we wish you the best in 2024.

Sincerely,

Joe Witt,
Minnesota Bankers Association

Rann Paynter
Michigan Bankers Association

Rose Oswald Poels
Wisconsin Bankers Association

Rick Clayburgh
North Dakota Bankers Association

Karl Adam
South Dakota Bankers Association

Sam Sill
Montana Bankers Association