

“Regulatory Relief” for Banking: Selected Legislation in the 114th Congress

(name redacted), Coordinator
Analyst in Financial Economics

(name redacted)
Specialist in Financial Economics

(name redacted)
Analyst in Financial Economics

(name redacted)
Specialist in Macroeconomic Policy

(name redacted)
Specialist in Financial Economics

(name redacted)
Specialist in Financial Economics

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Summary

The 114th Congress is considering legislation to provide “regulatory relief” for banks. The need for this relief, some argue, results from new regulations introduced in response to vulnerabilities that were identified during the financial crisis that began in 2007. Some have contended that the increased regulatory burden—the cost associated with government regulation and its implementation—is resulting in significant costs that restrain economic growth and consumers’ access to credit. Others, however, believe the current regulatory structure strengthens financial stability and increases protections for consumers, and they are concerned that regulatory relief for banks could negatively affect consumers and market stability. Regulatory relief proposals, therefore, may involve a trade-off between reducing costs associated with regulatory burden and reducing benefits of regulation.

This report discusses regulatory relief legislation for banks in the 114th Congress that, at the time this report was published, has seen legislative action. Many, but not all, of the bills would make changes to the Dodd-Frank Act (P.L. 111-203), wide-ranging financial reform enacted in response to the financial crisis. The bills analyzed in this report would provide targeted regulatory relief in a number of different areas:

- **Safety and Soundness Regulations.** Safety and soundness, or prudential, regulation is designed to ensure that a bank maintains profitability and avoids failure. After many banks failed during the financial crisis, the reforms implemented in the wake of the crisis were intended to make banks less likely to fail. While some view these efforts as essential to ensuring that the banking system is safe, others view the reforms as having gone too far and imposing excessive costs on banks. Examples of legislation include changes to the Volcker Rule, capital requirements, liquidity requirements applied to municipal bonds, and enhanced regulation for large banks.
- **Mortgage and Consumer Protection Regulations.** Several bills would modify regulations issued by the Consumer Financial Protection Bureau (CFPB), a regulator created by the Dodd-Frank Act to provide an increased regulatory emphasis on consumer protection. The Dodd-Frank Act gave the CFPB new authority and transferred existing authorities to it from the banking regulators. Many regulatory relief proposals could be viewed in light of a broader policy debate about whether the CFPB has struck the appropriate balance between consumer protection and regulatory burden. One legislative focus has been several mortgage-related CFPB rulemakings pursuant to the Dodd-Frank Act.
- **Supervision and Enforcement.** *Supervision* refers to regulators’ power to examine banks, instruct banks to modify their behaviors, and to impose reporting requirements on banks to ensure compliance with rules. *Enforcement* is the authority to take certain legal actions, such as impose fines, against an institution that fails to comply with rules and laws. Although regulators generally view their supervisory and enforcement actions as striking the appropriate balance between ensuring that institutions are well managed and minimizing the burden facing banks, others believe the regulators are overreaching and preventing banks from serving their customers. Examples of legislation include changes to call reports and bank exams, as well as legislation addressing “Operation Chokepoint.”
- **Capital Issuance.** Banks are partly funded by issuing capital to investors. Disclosure requirements and investor protections may better inform investors about the risks that they are assuming but can make it more costly for institutions

to raise capital. Whereas some view these existing regulatory requirements as important safeguards that ensure investors are making educated decisions, others see them as unnecessary red tape that stymies capital formation. The capital issuance legislative proposals discussed in this report are generally geared toward making it easier for financial institutions to raise funds.

Congress faces the question of how much discretion to give regulators in granting relief. Some bills leave it up to the regulators to determine how much relief should be granted, whereas others make relief mandatory. Some bills provide relief in areas regulators have already reduced regulatory burden. Some of the legislation is focused on providing relief for small banks, whereas other bills provide relief to the entire industry.

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Introduction

The 114th Congress is considering legislation to provide "regulatory relief" for banks.¹ The need for such relief, some argue, results from the increased regulation that was applied in response to vulnerabilities that became evident during the financial crisis that began in 2007. In the aftermath of the crisis, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act),² a wide-ranging package of regulatory reform legislation, was enacted.³ Bank failures spiked during the crisis, and changes to banking regulation were a key part of financial reform. As financial regulators have implemented the Dodd-Frank Act and other reforms, some in Congress claim that the pendulum has swung too far toward excessive regulation. They argue that the additional regulation has resulted in significant costs that have stymied economic growth and restricted consumers' access to credit. Others, however, contend the current regulatory structure has strengthened financial stability and increased protections for consumers. They are concerned that regulatory relief for banks could negatively affect consumers and market stability.

This report assesses banking regulatory relief proposals contained in bills that have been marked up by committee or have seen floor action in the 114th Congress. In the House, proposals had generally been considered individually in separate bills until September 2016, when many of these bills were combined with new provisions in the Financial CHOICE Act (H.R. 5983, FCA). In the Senate, proposals have been combined into one legislative package, the Financial Regulatory Improvement Act (S. 1484/S. 1910). For more information on these two comprehensive regulatory relief packages, see the text box below. Several proposals were also included in the version of H.R. 22, the Fixing America's Surface Transportation Act, which was signed into law as P.L. 114-94 on December 4, 2015.⁴

Comprehensive Regulatory Relief Packages

The Financial Regulatory Improvement Act (S. 1484), sponsored by Chairman Richard Shelby, was reported by the Senate Banking Committee on June 2, 2015. It was then included, along with other provisions related to financial regulation, in the FY2016 Financial Services and General Government Appropriations Act (S. 1910), which was reported by the Senate Appropriations Committee on July 30, 2015. (Only one provision from S. 1484, related to mortgage servicing assets, was included in the Consolidated Appropriations Act, 2016 [H.R. 2029], which was signed into law as P.L. 114-113 on December 18, 2015.) The Congressional Budget Office (CBO) estimated that S. 1484 "would increase net direct spending by \$284 million and reduce revenues by \$93 million over the next 10 years, leading to a net increase in the deficit of \$377 million over the 2016-2025 period."⁵ Of the \$377 million increase in the deficit, CBO attributes \$213 million to an increase in "general administrative costs" and \$164 million to provisions affecting systemically important financial institutions (some of which are banks).⁶ CBO does not provide cost estimates for each section, so it is unclear how much of the \$377 million is related to banking regulatory relief. (This report discusses only those provisions of S. 1484/S. 1910 related to regulatory relief and banking.)

The Financial CHOICE Act (H.R. 5983), sponsored by Chairman Jeb Hensarling, was ordered to be reported by the

¹ For a summary of the regulatory relief debate, see CRS In Focus IF10162, *Introduction to Financial Services: "Regulatory Relief,"* by (name redacted) and (name redacted)

² P.L. 111-203.

³ For a summary, see CRS Report R41350, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Background and Summary*, coordinated by (name redacted)

⁴ For more details, see **Appendix D**.

⁵ U.S. Congressional Budget Office (CBO), *Cost Estimate: S. 1484, Financial Regulatory Improvement Act of 2015, as Reported by the Senate Committee on Banking, Housing, and Urban Affairs on June 2, 2015*, July 29, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/s1484.pdf>.

⁶ These provisions are discussed below in the section entitled "Enhanced Regulation of Large Banks (H.R. 1309, H.R. 5983, H.R. 6392, S. 1484/S. 1910)."

House Committee on Financial Services on September 13, 2016. The bill is a wide-ranging proposal with 11 titles that would alter many parts of the financial regulatory system. The bill combined new provisions with bills that had previously seen legislative action in the House as stand-alone bills.

Because banks are involved in many different activities, this report does not address all regulatory relief proposals that would affect each aspect of a bank's business (e.g., it does not cover proposals affecting banks' involvement in areas such as derivatives) but focuses on those proposals that address the traditional areas of banking, such as taking deposits and offering loans.⁷ Although many of the proposals would modify regulations issued after the crisis, some would adjust policies that predated the financial crisis and some proposals are characterized as technical fixes. Further, the report covers only the regulatory relief banking legislation that has seen legislative action.

The proposals discussed in this report vary with regard to the type of relief, including to whom relief would be provided and the manner in which it would be provided. For organizational purposes, this report classifies regulatory relief proposals into the categories of safety and soundness, mortgage and consumer protection, supervision and enforcement, or capital issuance. For each proposal, the report explains what the bill would do and the main arguments offered by its supporters and opponents.

Regulatory Burden

In assessing whether regulatory relief is called for or whether a regulation has not gone far enough, a central question is whether an appropriate trade-off has been struck between the benefits and costs of regulation. The different objectives and potential benefits of financial regulation include enhancing the safety and soundness of certain institutions; protecting consumers and investors from fraud, manipulation, and discrimination; and promoting financial stability while reducing systemic risk. The costs associated with government regulation are referred to as *regulatory burden*. The presence of regulatory burden does not necessarily mean that a regulation is undesirable or should be repealed. A regulation can have benefits that could outweigh its costs, but the presence of costs means, tautologically, that there is regulatory burden. Regulatory requirements often are imposed on the providers of financial services, so banks frequently are the focus of discussions about regulatory burden. But some costs of regulation are passed on to consumers, so consumers also may benefit from relief. Any benefits to banks or consumers of regulatory relief, however, would need to be balanced against a potential reduction to consumer protection and to the other benefits of regulation.

The concept of regulatory burden can be contrasted with the phrase *unduly burdensome*. Whereas regulatory burden is about the costs associated with a regulation, unduly burdensome refers to the balance between benefits and costs. For example, some would consider a regulation to be unduly burdensome if costs were in excess of benefits or the same benefits could be achieved at a lower cost. But the mere presence of regulatory burden does not mean that a regulation is unduly burdensome. Policymakers advocating for regulatory relief argue that the regulatory burden associated with certain regulations rises to the level of being unduly burdensome for banks, whereas critics of those relief proposals typically believe the benefits of regulation outweigh the regulatory burden.

⁷ Some of the bills addressed in this report would modify a regulation that applies to banks and nonbanks engaged in a specific activity.

Types of Regulatory Relief Proposals

As relief proposals for banks are debated, a useful framework to categorize proposals includes assessing to *whom* relief would be provided and *how* relief would be provided. Relief could be provided either to all banks to which a regulation applies or to only a subset of banks based on size, type, or the activities the banks perform. The perceived need for relief for small banks has been emphasized in the 114th Congress, and **Table 1** summarizes legislative proposals in this report that have a size threshold. Often in the regulatory relief debate, small banks are characterized as “community banks,” although there is no consensus on what size threshold divides small banks from large or what are the defining characteristics of a community bank.⁸

Table 1. Selected Legislative Proposals Changing a Size Threshold

Topic	Bill Number	Proposed Exemption Level
Volcker Rule—Community Bank Exemption	S. 1484/S. 1910	\$10 billion in assets, indexed to GDP
Thresholds for Enhanced Regulation	S. 1484/S. 1910	\$500 billion in assets, with a designation process for entities between \$50 billion and \$500 billion in assets
Thresholds for Enhanced Regulation	H.R. 1309, H.R. 6392	Replaces \$50 billion threshold with a designation process unless entity has already been designated by the Financial Stability Board
Regulators' Exemptive Authority	S. 1910	\$10 billion in assets
Small Bank Holding Company	H.R. 3791, H.R. 5983	\$5 billion in assets
Exam Frequency	S. 1484/S. 1910, H.R. 22, H.R. 1553	\$200 million, \$1 billion in assets
Consumer Financial Protection Bureau (CFPB) Supervisory Threshold	S. 1484/S. 1910, H.R. 5983	\$50 billion in assets
Escrow	H.R. 1529, H.R. 5983	\$10 billion in assets
Mortgage Servicing	H.R. 1529, H.R. 5983	Service 20,000 mortgages
Holding Company Threshold Equalization	S. 1484/S. 1910, H.R. 22, H.R. 37, H.R. 1334	SHLC with \$10 million in assets and 1,200/2,000 shareholders

Source: Table created by the Congressional Research Service (CRS).

Notes: See text for details. SHLC = savings and loan holding company. Additional regulations discussed in this report have size-based thresholds, but Table 1 only highlights legislative proposals that would add or change exemption levels. Some of the exemption levels are indexed to gross domestic product (GDP). For more on GDP indexing, see **Table A-1**.

Regulatory relief can be provided in different forms, including by repealing entire provisions, by providing exemptions from specific requirements, or by tailoring a requirement so that it still applies to certain entities but does so in a less burdensome way. Examples of different forms of tailoring are streamlining a regulation, grandfathering existing firms or types of instruments from a regulation, and phasing in a new regulation over time. Modifications can be made to regulations

⁸ For an analysis of the regulatory burden on small banks, see CRS Report R43999, *An Analysis of the Regulatory Burden on Small Banks*, by (name redacted) and (name redacted)

stemming from statutory requirements, regulatory or judicial interpretations of statute, or requirements originating from regulators' broad discretionary powers.

Typically, in the area of financial regulation, Congress sets the broad goals of regulation in statute and leaves it to regulators to fill in the details. Many of the legislative proposals analyzed in this report, however, would make changes to specific details of the regulation that regulators have issued. Thus, some may oppose such proposals on the grounds that Congress is overriding regulator discretion and lacks the expertise to properly make detailed, technical regulatory judgments. In some cases, Congress might nevertheless determine that narrow intervention is justified because regulators have misinterpreted its will or are not considering other relevant policy objectives.

Safety and Soundness Regulations

The goal of safety and soundness (or prudential) regulation is to ensure that a bank maintains profitability and avoids failure. The rationale for safety and soundness regulation is to protect taxpayers (who backstop federal deposit insurance) and to maintain financial stability. Regulators monitor the bank's risk profile and set various metrics that banks must maintain in areas such as capital and liquidity. After the spike in bank failures surrounding the crisis, many of the reforms implemented in the wake of the financial crisis were intended to make banks less likely to fail. Whereas some view these efforts as essential to ensuring the banking system is safe, others view the reforms as having gone too far and imposing excessive costs on banks.

Leverage Ratio as an Alternative to Current Bank Regulation (H.R. 5983)⁹

Under Title I of H.R. 5983, a banking organization¹⁰ that has received high ratings on recent examinations could choose to be subject to a higher, 10% leverage ratio.¹¹ In exchange for choosing to be subject to the 10% leverage ratio, banks would be exempt from risk-weighted capital ratios; liquidity requirements; certain merger, acquisition, and consolidation restrictions; limitations on dividends; and other regulations. A bank would have the option to follow current regulatory requirements or this new regulatory approach.

Some of the regulations from which a bank could receive relief are regulations that apply to all banks, such as the risk-weighted capital ratios. Other regulations from which a bank could receive relief under the FCA would only apply to larger banks (with an asset threshold of \$50 billion to \$700 billion, depending on the provision). For example, banks opting in to the new leverage ratio approach would be exempt from the Dodd-Frank Act's Section 165 enhanced prudential regulations except for stress tests and other regulations based on financial stability considerations. The enhanced regulatory regime can include capital standards, liquidity standards, counterparty limits, risk-management standards, and "living will" requirements. Regulators would still have

⁹ This section was authored by Sean Hoskins.

¹⁰ A banking organization is defined in the Financial CHOICE Act to include an insured depository institution, an insured credit union, a depository institution holding company, a company that is treated as a bank holding company for purposes of Section 8 of the International Banking Act, and certain U.S. intermediate holding companies established by foreign banking organizations.

¹¹ Larger and more complex banks would have to comply with the supplemental leverage ratio (which includes off-balance-sheet exposures) while credit unions and more traditional banks would have to comply with narrower definitions of the leverage ratio.

authority to conduct stress tests¹² on banks with over \$50 billion in assets (but would no longer have the authority to require company-run stress tests for banks with between \$10 billion and \$50 billion in assets) that opted for the new regulatory approach but would be limited in their ability to require them to alter their capital levels.

Background. With more than 500 banks failing between 2007 and 2014,¹³ strengthening prudential regulation has been a major goal of post-crisis financial reforms. Prudential regulation covers a broad set of a bank's activities, including assessing whether a bank will be able to meet its obligations during a market downturn, evaluating the quality of its assets and management team, and other factors. One of the main areas of focus is bank capital adequacy.

Capital is the difference between the value of a bank's assets and its liabilities and is an indicator of a bank's ability to absorb losses. If a bank has \$100 worth of assets and \$90 of liabilities, then the bank has capital of \$10. If the value of the assets decreases by \$5 to \$95 and the bank still has \$90 in liabilities, then the \$5 decline in asset value would be absorbed by the capital, which would decrease from \$10 to \$5.

Capital is often measured as the ratio of capital to the bank's assets. A 10% capital ratio, for example, would imply \$10 of capital for every \$100 of assets. Banks are required to satisfy several different capital ratios, but the ratios fall into two main categories: (1) a leverage ratio and (2) a risk-weighted asset ratio. Failure to satisfy the required ratios could lead to regulators taking corrective action against a bank, including ultimately shutting the bank down.

Under a leverage ratio, all assets regardless of riskiness are treated the same and, as in the previous example, the ratio is calculated by dividing capital by assets. Under a risk-weighted asset ratio, each asset is assigned a risk weight to account for the fact that some assets are more likely to lose value than others. Riskier assets receive a higher risk weight, which requires banks to hold more capital—and so be better able to absorb losses—to meet the ratio requirement.

Leverage Ratio and Risk-Weighted Ratio Sample Calculations

$$\text{Leverage Ratio} = \frac{\text{Capital}}{\text{Assets}}$$

$$\text{Risk-Weighted Ratio} = \frac{\text{Capital}}{(\text{Risk Weight for Asset 1}) \times (\text{Asset 1}) + (\text{Risk Weight for Asset 2}) \times (\text{Asset 2})}$$

The specifics of the capital ratios—what the minimum levels are, what qualifies as capital, what the asset risk weights are, what is included in total assets—were proposed by the Basel Committee on Bank Supervision and then implemented by the U.S. financial regulators.¹⁴ The Basel Committee “is the primary global standard-setter for the prudential regulation of banks and

¹² For information on current stress tests, see the Federal Reserve, “Stress Tests and Capital Planning,” at <http://www.federalreserve.gov/bankinfo/reg/stress-tests-capital-planning.htm>.

¹³ For more on bank failures, see CRS In Focus IF10055, *Bank Failures and the FDIC*, by (name redacted)

¹⁴ For more on the Basel III regulations, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by (name redacted).

provides a forum for cooperation on banking supervisory matters.”¹⁵ The most recent proposed comprehensive reform proposal is referred to as Basel III.

The capital ratios that a bank must satisfy and how those levels are computed varies based on a bank's size and complexity. The largest banks are required to hold more capital than smaller, less complex banks.¹⁶ In regards to the simple leverage ratio, most banks are required to meet a 4% leverage ratio.¹⁷ Large banks are subject to a supplementary leverage ratio ranging from 3% to 6% depending on their size and the organizational unit within the bank.¹⁸ The supplementary leverage ratio is more expansive than the leverage ratio because it takes into account certain off-balance-sheet assets and exposures.

The required risk-weighted ratios depend on bank size and capital quality (some types of capital are considered to be less effective at absorbing losses than other types, and so considered lower quality). Most banks must meet a risk-weighted ratio of 4.5% for the highest quality capital and of 6% and 8% for lower quality capital. Banks are then required to have an additional 2.5% of high quality capital on top of those levels as part of the “capital conservation buffer.”¹⁹ The eight U.S. banks that have been designated as global systemically important banks (G-SIBs)²⁰ face a capital surcharge that can range from 1% to 4.5%.²¹ Although currently set at zero and not yet fully phased in, a large bank also could be subject to a countercyclical buffer of up to 2.5% of risk-weighted assets if regulators deem it necessary.²²

Policy Discussion. Some economists argue that it is important to have both a risk-weighted ratio and a leverage ratio because the two complement each other.²³ A basic tenet of finance is that riskier assets have a higher *expected* rate of return to compensate the investor for bearing more risk. Without risk weighting, banks would have an incentive to hold riskier assets because capital is costly and the same amount of capital must be held against riskier and safer assets. For example, banks might decide to shift out of certain lines of business that involve holding large amounts of safe assets, such as cash, if risk-weighted ratios were replaced by a higher leverage ratio. But risk weights may prove inaccurate. For example, banks held highly rated mortgage-backed securities (MBSs) before the crisis, in part because those assets had a higher expected rate

¹⁵ Bank for International Settlements, “About the Basel Committee,” at <https://www.bis.org/bcbs/about.htm?m=3|14|573>.

¹⁶ The largest banks are also referred to as “advanced approaches banks” (referring to the different approach for capital regulation to which they are subject), which are institutions with at least \$250 billion in consolidated assets or on-balance-sheet foreign exposures of at least \$10 billion.

¹⁷ Federal Reserve, *Final Rule on Enhanced Regulatory Capital Standards—Implications for Community Banking Organizations*, July 2013, at <http://www.federalreserve.gov/newsevents/press/bcreg/commbankguide20130702.pdf>.

¹⁸ Federal Deposit Insurance Corporation (FDIC), Federal Reserve, and Office of the Comptroller of the Currency (OCC), “Regulatory Capital Rules: Regulatory Capital, Revisions to the Supplementary Leverage Ratio,” 79 *Federal Register* 57725, September 26, 2014.

¹⁹ Federal Reserve, *Final Rule on Enhanced Regulatory Capital Standards—Implications for Community Banking Organizations*, July 2013, at <http://www.federalreserve.gov/newsevents/press/bcreg/commbankguide20130702.pdf>.

²⁰ For more on G-SIBs and the designation process, see CRS Insight IN10388, *Designation of Global ‘Too Big To Fail’ Firms*, by (name redacted) and (name redacted).

²¹ Federal Reserve, “Regulatory Capital Rules: Implementation of Risk-Based Capital,” 80 *Federal Register* 49082, August 14, 2015.

²² Federal Reserve, “Regulatory Capital Rules: The Federal Reserve Board’s Framework,” 81 *Federal Register* 5661, February 3, 2016.

²³ See Chair Yellen comments during U.S. Congress, House Committee on Financial Services, *Monetary Policy and the State of the Economy*, 114th Cong., 2nd sess., June 22, 2016, at <http://www.cq.com/doc/congressionaltranscripts-4915133?2>.

of return than other assets with the same risk weight. MBSs then suffered unexpectedly large losses during the crisis. Thus, the leverage ratio can be thought of as a backstop to ensure that incentives posed by risk-weighted capital ratios to minimize capital and maximize risk within a risk weight do not result in a bank holding insufficient capital.

Others argue that the risk-weighted system provides “needless complexity” and is an example of “central planning.” The complexity benefits those largest banks that have the resources to absorb the added regulatory cost. They believe that the risk weights in place prior to the financial crisis were poorly calibrated and “encouraged financial firms to crowd into these” unexpectedly risky assets, exacerbating the downturn. Risk weighting may encourage regulators to set the weights so as “to provide a cheaper source of funding for governments and projects favored by politicians,” which can lead to a distortion in credit allocation. Better, they argue, to eliminate the risk-weighted system for those banks that agree to hold more capital and satisfy a higher, simpler leverage ratio.²⁴

While a 10% leverage ratio is significantly more capital than what banks are currently *required* to hold, it is not necessarily more capital than they are currently holding. For example, under the current definition of the leverage ratio, banks except those with more than \$250 billion in assets had an average leverage ratio above 10% in the first half of 2016.²⁵ For traditional banks, as defined in H.R. 5983, the bill uses a slightly different definition of leverage ratio than found in regulatory filings, however, making a direct comparison to the bill’s requirement difficult. For traditional banks that are already above a 10% ratio, H.R. 5983 would provide them with regulatory relief without requiring them to hold more capital.

In addition to the issue of whether it is better to have either both a risk-weighted ratio and a leverage ratio or only a leverage ratio is the broader issue of the role of capital in bank regulation. Those who argue in favor of having only a higher leverage ratio also generally support eliminating other forms of prudential regulation, such as liquidity requirements, asset concentration guidelines, and counterparty limits. They argue that capital is essential to absorbing losses and, so long as sufficient capital is in place, banks should not be subject to excessive regulatory micromanagement.²⁶ Others, however, believe that the different components of prudential regulation each play an important role in ensuring the safety and soundness of financial institutions and are essential complements to bank capital. In other words, capital can absorb losses, but unlike other forms of prudential regulation, it cannot make losses less likely.

Volcker Rule

Section 619 of the Dodd-Frank Act, also known as the *Volcker Rule*, has two main parts—it prohibits banks from proprietary trading of “risky” assets and from “certain relationships” with risky investment funds, including acquiring or retaining “any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund.”²⁷ The statute carves out exemptions from the rule for trading activities that Congress viewed as legitimate for banks to

²⁴ Quotations from House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 6, p. 8, and p. 9, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

²⁵ Data from FDIC, *Quarterly Banking Profile*, Second Quarter, 2016, p. 9.

²⁶ House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 7.

²⁷ P.L. 111-203, §619. For more information, see CRS Legal Sidebar, *What Companies Must Comply with the Volcker Rule?*, (name redacted).

participate in, such as risk-mitigating hedging and market-making related to broker-dealer activities. It also exempts certain securities, including those issued by the federal government, government agencies, states, and municipalities, from the ban on proprietary trading.²⁸ The final rule implementing the Volcker Rule was adopted on January 31, 2014.²⁹

Repeal (H.R. 5983)³⁰

Section 901 of H.R. 5983 would repeal the Volcker Rule in its entirety.

Policy Discussion. The Volcker Rule is named after Paul Volcker, former Chair of the Federal Reserve (Fed) and former Chair of President Obama's Economic Recovery Advisory Board. Volcker proposed this rule on the grounds that

adding further layers of risk to the inherent risks of essential commercial bank functions doesn't make sense, not when those risks arise from more speculative activities far better suited for other areas of the financial markets.... Apart from the risks inherent in these activities, they also present virtually insolvable conflicts of interest with customer relationships, conflicts that simply cannot be escaped by an elaboration of so-called Chinese walls between different divisions of an institution. The further point is that the three activities at issue—which in themselves are legitimate and useful parts of our capital markets—are in no way dependent on commercial banks' ownership.³¹

Volcker also pointed out that in the presence of deposit insurance, banks are implicitly backed by taxpayers, which presents moral hazard problems. Thus, support for the Volcker Rule has often been posed as preventing banks from "gambling" in securities markets with taxpayer-backed deposits.³² In Volcker's view, moving these activities out of the banking system reduces moral hazard and systemic risk concerns.

While proprietary trading and hedge fund sponsorship pose risks, it is not clear whether they pose greater risks to bank solvency and financial stability than "traditional" banking activities, such as mortgage lending. They could be viewed as posing *additional* risks that might make banks more likely to fail, but alternatively those risks might better diversify a bank's risks, making it less likely to fail. Further, the Volcker Rule bans these activities from any subsidiary within a bank holding company, including non-bank subsidiaries. Proprietary trading in non-bank subsidiaries would be less likely to pose concerns about moral hazard and taxpayer risk unless the firm poses too big to fail problems.

A House Financial Services Committee majority report argues that the Volcker Rule is "a solution in search of a problem—it seeks to address activities that had nothing to do with the financial crisis, and its practical effect has been to undermine financial stability rather than preserve it."³³

²⁸ For a summary of the Volcker Rule, see Federal Reserve, Commodity Futures Trading Commission (CFTC), FDIC, OCC, and Securities and Exchange Commission (SEC), "Final Rules to Implement the 'Volcker Rule,'" at <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a3.pdf>.

²⁹ "Prohibitions and Restrictions on Proprietary Trading and Certain Interests," 79 *Federal Register* 5778, January 31, 2014.

³⁰ This section was authored by (name redacted), specialist in Macroeconomic Policy.

³¹ Paul Volcker, "How to Reform Our Financial System," *New York Times*, January 30, 2010.

³² See, for example, House Financial Services Committee, "Waters: Dodd-Frank Repeal is Truly the Wrong Choice," press release, June 24, 2016, at <http://democrats.financialservices.house.gov/news/documentsingle.aspx?DocumentID=399901>.

³³ House Financial Services Committee, *The Financial CHOICE Act: Comprehensive Summary*, June 23, 2016, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

A practical challenge posed by the Volcker Rule is differentiating between proprietary trading and permissible activities, such as hedging and market making. For example, how can regulators determine whether a broker-dealer is holding a security as inventory for market making, as a hedge against another risk, or as a speculative investment? Differentiating between these motives creates regulatory complexity, and if the benefits are not sufficient, the Volcker Rule might be unduly burdensome. The House Financial Services Committee report argues that banks will alter their behavior to avoid this regulatory burden, and this will reduce financial market efficiency:

The Volcker Rule will increase borrowing costs for businesses, lower investment returns for households, and reduce economic activity overall because it constrains market-making activity that has already reduced liquidity in key fixed-income markets, including the corporate bond market.³⁴

Exemption for Community Banks (S. 1484/S. 1910)³⁵

Section 115 of S. 1484 (Section 916 of S. 1910) would exempt banks with total consolidated assets of \$10 billion or less (indexed in future years to the growth in GDP) from the Volcker Rule. Despite the exemption, regulators would be given discretion to apply the Volcker Rule to individual small banks if they determine that the bank's activities are "inconsistent with traditional banking activities or due to their nature or volume pose a risk to the safety and soundness of the insured depository institution."

Background. Banks of all sizes must comply with the Volcker Rule, but regulators have adopted streamlined compliance requirements for banks with less than \$10 billion in assets. Small banks with activities covered by the Volcker Rule can meet the requirements of the rule within existing compliance policies and procedures. However, according to the FDIC's guidance for community banks accompanying the Volcker Rule,

The vast majority of these community banks have little or no involvement in prohibited proprietary trading or investment activities in covered funds. Accordingly, community banks do not have any compliance obligations under the Final Rule if they do not engage in any covered activities other than trading in certain government, agency, State or municipal obligations.³⁶

Policy Discussion. Regulators contend that "the vast majority of community banks" who do not face compliance obligations do not face excessive burden. Banks argue that the act of evaluating the Volcker Rule to ensure that they are in compliance is burdensome in and of itself.

The fact that the vast majority of community banks do not engage in activities subject to the Volcker Rule has been used by different bank regulatory officials as a rationale to support and oppose an exemption from the Volcker Rule for small banks. On the one hand, Federal Reserve Governor Daniel Tarullo argued in favor of an exemption on the grounds that "both community banks and supervisors would benefit from not having to focus on formal compliance with regulation of matters that are unlikely to pose problems at smaller banks."³⁷ On the other hand, Federal Deposit Insurance Corporation (FDIC) Vice Chairman Thomas Hoenig says that among

³⁴ House Financial Services Committee, *The Financial CHOICE Act: Comprehensive Summary*, June 23, 2016, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

³⁵ This section was authored by (name redacted), specialist in Macroeconomic Policy.

³⁶ FDIC, *The Volcker Rule: Community Bank App*, at <https://www.fdic.gov/regulations/reform/volcker/summary.html>.

³⁷ Federal Reserve Gov. Daniel Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks," speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

community banks subject to compliance requirements, those with traditional hedging activities can comply simply by having clear policies and procedures in place that can be reviewed during the normal examination process. Of the remainder, he estimates that the number of community banks facing significant compliance costs represent “less than 400 of a total of approximately 6,400 smaller banks in the U.S. And of these 400, most will find that their trading-like activities are already exempt from the Volcker Rule. If the remainder of these banks have the expertise to engage in complex trading, they should also have the expertise to comply with Volcker Rule.” He concludes that

On balance, therefore, a blanket exemption for smaller institutions to engage in proprietary trading and yet be exempt from the Volcker Rule is unwise. A blanket exemption would provide no meaningful regulatory burden relief for the vast majority of community banks that do not engage at all in the activities that the Volcker Rule restricts. However, a blanket exemption for this subset of banks would invite the group to use taxpayer subsidized funds to engage in proprietary trading and investment activities that should be conducted in the marketplace, outside of the [federal] safety net.³⁸

CLOs and the Volcker Rule (H.R. 37)³⁹

The Promoting Job Creation and Reducing Small Business Burdens Act (H.R. 37) passed the House on January 14, 2015. Title VIII of H.R. 37 would modify a provision of the final rule implementing the Volcker Rule. It would modify the Volcker Rule’s treatment of certain collateralized loan obligations (CLOs) as impermissible covered fund investments. It would allow banks with investments in certain CLOs issued before January 31, 2014, an additional two years, until July 21, 2019, to be in compliance with the Volcker Rule.

Background. H.R. 37 involves the part of the Volcker Rule prohibiting “certain relationships” with “risky” investment funds. A CLO is a form of securitization in which a pool of loans (typically, commercial loans) is funded by issuing securities. CLOs provide nearly \$300 billion in financing to U.S. companies.⁴⁰ In the final rule implementing the Volcker Rule, many of the trusts used to facilitate CLOs were included in the definition of risky investment funds. As a result, banks would have to divest themselves of certain CLO-related securities if the securities conveyed an impermissible interest in the trust. The Volcker Rule does not ban CLOs or banking organizations from holding CLOs; rather, it prohibits banking organizations from owning securities conferring ownership-like rights in CLOs.

Regulators already have exercised their discretion to extend the conformance period for banks to divest themselves of these CLO-related assets to July 2017. They announced that they were not authorized to grant further temporary extensions. H.R. 37 would extend the conformance period to 2019 for CLOs.⁴¹ H.R. 37 applies only to banks that hold securities issued by existing CLOs funded by commercial loans. It would limit the extension period for conformance to those CLO securities issued prior to January 31, 2014. Going forward, bank participation in newly issued

³⁸ Thomas Hoenig, speech at the National Press Club, April 15, 2015, at <https://www.fdic.gov/news/news/speeches/spapril1515.html>.

³⁹ This section was authored by (name redacted), specialist in Financial Economics.

⁴⁰ U.S. Congress, House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises, *The Dodd-Frank Act’s Impact on Asset-Backed Securities*, Testimony of Meredith Coffey, 113th Cong., 2nd sess., February 26, 2014.

⁴¹ See CRS Legal Sidebar WSLG1143, *Congress Contemplates Extending Volcker Rule Conformance Period for CLO Investments*, by (name redacted) .

CLOs would have to be structured to comply with the Volcker Rule's prohibition of bank interests in risky investment firms.⁴²

Policy Discussion. The potential economic impact of H.R. 37 depends on the characteristics of CLO-related obligations already held in the banking system. If banks did not expect their CLO holdings to be prohibited by the Volcker Rule, they may not have made any preparations to comply with it. Thus, proponents of extending the conformance period argue that rapid divestiture of CLO-related securities could force banks to sell these securities at a loss, perhaps in fire sales, if an extension is not granted and point out that the bill merely changes the grandfathering date of existing commercial loan-related CLO securities from 2017 to 2019. They argue that stress in the banking system without the extension may curtail credit available to small- and medium-sized commercial businesses.⁴³

Opponents of Title VIII of H.R. 37, including the White House, argue that extending the conformance period would undermine the intent of the Volcker Rule and allow risky securities to remain in the banking system. They contend that it could result in future destabilizing losses for banks that hold risky securities.⁴⁴

Naming Restrictions (H.R. 4096)

The Investor Clarity and Bank Parity Act (H.R. 4096), passed by the House on April 26, 2016, would allow an investment advisor that is affiliated with a bank or bank holding company to share the advisor's name with the hedge fund or private equity fund it manages if certain criteria were met. Those criteria include the investment advisor not being a bank or bank holding company, sharing the same name as a bank or bank holding company, or having bank in the name.

Background. As mentioned above, the Volcker Rule prohibits banking entities from "certain relationships" with risky investment funds, including acquiring or retaining "any equity, partnership, or other ownership interest in or sponsor a hedge fund or a private equity fund." Banking entities include all FDIC-insured bank and thrift institutions; all bank, thrift, or financial holding companies; all foreign banking operations with certain types of presence in the United States; and all affiliates and subsidiaries of any of these entities.⁴⁵

A banking entity is allowed, however, to organize and offer a private equity or hedge fund if certain conditions are met,⁴⁶ including that "the banking entity does not share with the hedge fund or private equity fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name."⁴⁷ An investment manager that is affiliated with a bank or bank

⁴² See CRS Legal Sidebar WSLG767, *What Companies Must Comply with the Volcker Rule?*, by (name redacted) ..

⁴³ Hamilton Place Strategies, *Regulating Risk: Implementation of New Regulation*, January 2015, at <http://hamiltonplacestrategies.com/sites/default/files/newsfiles/HPS%20White%20Paper%20-%20Regulating%20Risk%20-%20Volcker%20and%20CLOs.pdf>.

⁴⁴ Executive Office of the President, *Statement of Administrative Policy: H.R. 37—Promoting Job Creation and Reducing Small Business Burdens Act*, January 12, 2015, at http://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr37r_20150112.pdf.

⁴⁵ 12 U.S.C. §1851(h)(1).

⁴⁶ For a list of permitted covered fund investments and activities, see "Permitted Covered Fund Investments and Activities" in CRS Report R43440, *The Volcker Rule: A Legal Analysis*, by (name redacted) and (name redacted) ..

⁴⁷ 12 U.S.C. §1851(d)(1)(G)(vi).

holding company is considered a banking entity and, therefore, cannot name a fund that it manages after itself.

The naming prohibition in the Volcker Rule is intended to make it less likely that "that a banking entity would otherwise come under pressure for reputational reasons to directly or indirectly assist a covered fund under distress that bears the banking entity's name."⁴⁸ As explained in an example from the markup for H.R. 4096, currently, "if XYZ Investment Advisers is an affiliate of XYZ Bank and sponsors a real estate fund, the real estate fund could not be named XYZ Real Estate Fund."⁴⁹ H.R. 4096 would modify the naming prohibition by allowing an investment advisor that is not a bank or bank holding company to share its name with the fund it manages if the investment advisor's name is sufficiently different from its parent company's name and does not have bank in the name. So under H.R. 4096, if ABC Investment Advisers is an affiliate of XYZ Bank and sponsors a real estate fund, the real estate fund could be named ABC Real Estate Fund (assuming the necessary criteria are met), but could still not be named XYZ Real Estate Fund.

Policy Discussion. Supporters of H.R. 4096 argue that an investment manager naming its fund after itself is industry practice and serves "the goal of providing clarity to investors about who is managing a covered fund."⁵⁰ If the investment manager has a completely different name than the bank with which it is affiliated, they argue that it is difficult to see how naming the fund after the investment manager "could lead to an expectation that the taxpayer-backed bank which didn't even organize the fund would bail the fund out."⁵¹

Critics of H.R. 4096 argue that it could "in some case permit funds to be named after significant bank affiliates that the markets strongly associate with the overall holding company, creating a reputational risk to the bank if the fund failed, and an inference of implicit sponsorship."⁵² Critics cite Merrill Lynch's relationship to Bank of America as one possible example. Some of the opponents of H.R. 4096 note that they would withdraw their objection if, instead of a broad change to the naming prohibition, H.R. 4096 "were modified to grant regulators discretion over the decision of whether or not to grant the specific exemption from naming restrictions laid out in the bill."⁵³

CBO estimates that H.R. 4096 as ordered to be reported would have an insignificant effect on spending and revenues."⁵⁴

⁴⁸ CFTC, "Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds," 79 *Federal Register* 5985, January 31, 2014.

⁴⁹ Attributed to Rep. Steve Stivers by CQ Congressional Transcripts, "House Financial Services Committee Holds Markup on Regulatory Reform Legislation," March 2, 2016, at <http://www.cq.com/doc/financialtranscripts-4846773?7>.

⁵⁰ U.S. Congress, House Committee on Financial Services, *Testimony of Mr. Jeffrey Plunkett*, 114th Cong., 2nd sess., February 24, 2016.

⁵¹ Attributed to Rep. Carolyn Maloney by CQ Congressional Transcripts, "House Financial Services Committee Holds Markup on Regulatory Reform Legislation," March 2, 2016, at <http://www.cq.com/doc/financialtranscripts-4846773?7>.

⁵² Letter from Americans for Financial Reform to Members of Congress, March 2, 2016, at <http://ourfinancialsecurity.org/2016/03/letter-to-congress-afr-opposes-new-exemptions-to-the-volcker-rule-urges-committee-to-reject-hr-4096/>.

⁵³ Letter from Americans for Financial Reform to Members of Congress, March 2, 2016, at <http://ourfinancialsecurity.org/2016/03/letter-to-congress-afr-opposes-new-exemptions-to-the-volcker-rule-urges-committee-to-reject-hr-4096/>.

⁵⁴ CBO, *Cost Estimate: H.R. 4096 Investor Clarity and Bank Parity Act as ordered reported by the House Committee on Financial Services on March 2, 2016*, March 24, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr4096.pdf>

Change to the "Collins Amendment" (H.R. 22, S. 1484/S. 1910)⁵⁵

Section 171 of the Dodd-Frank Act, known generally as the *Collins Amendment*, requires bank holding companies, thrift holding companies, and non-bank "systemically important financial institutions" (SIFIs) to have capital and leverage requirements at the holding company level that are no lower than those applied at the depository subsidiary. As a result, certain capital instruments, such as trust preferred securities, that had previously counted toward certain capital requirements at the holding company level would no longer be eligible. The Collins Amendment allowed capital instruments that were otherwise no longer eligible to receive grandfathered treatment if they were issued before May 19, 2010. For institutions with more than \$15 billion in assets as of December 31, 2009, the instruments would be grandfathered until January 1, 2016. For institutions with less than \$15 billion in assets, instruments issued before May 19, 2010, would be permanently grandfathered.⁵⁶ For institutions with less than \$1 billion (those subject to the Small Bank Holding Company policy), capital instruments issued on any (past or future) date would be eligible for capital requirements.

Section 123 of S. 1484 (Section 924 of S. 1910) would change the date for determining whether banks were above the \$15 billion threshold from December 31, 2009, to "December 31, 2009 or March 31, 2010." A similar provision was included in the Fixing America's Surface Transportation Act (H.R. 22/P.L. 114-94). According to testimony from Emigrant Bank, this statutory change will make its capital instruments eligible to be grandfathered from the Collins Amendment.⁵⁷

Authority to Provide Exemptions or Tailoring from Regulations (H.R. 2896, H.R. 5983, S. 1910)⁵⁸

The Taking Account of Institutions with Low Operation Risk Act (H.R. 2896) was ordered to be reported by the House Financial Services Committee on March 2, 2016. It was also included in Section 1146 of H.R. 5983. When promulgating a rule, it would require the federal banking regulators, CFPB, and NCUA to "take into consideration the risk and business models" of the affected firms, "determine the necessity, appropriateness, and impact" of the regulation, and tailor the regulation "in a manner that limits the regulatory compliance impact, cost, liability risk, and other burden as is appropriate...." The legislation would leave it to the regulators to determine who should benefit from tailoring, as opposed to basing it on size, for example. The legislation would require the agencies to apply its requirements to regulations adopted in the past five years and new regulations adopted in the future. It would also require the regulators to annually testify and report to Congress on tailoring.

⁵⁵ This section was authored by (name redacted), specialist in Macroeconomic Policy.

⁵⁶ The regulation implementing this section places limits on the share of grandfathered instruments that can be used to meet capital requirements. See Office of the Comptroller of the Currency and Federal Reserve, "Regulatory Capital Rules," 78 *Federal Register*, October 11, 2013, p. 62052, <http://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>.

⁵⁷ Richard Wald, Emigrant Bank, Testimony Before U.S. Congress, House Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit, *The Impact of the Dodd-Frank Act*, 112th Cong., 2nd sess., May 18, 2012, <http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=295210>. This provision was included in H.R. 3128 in the 112th Congress.

⁵⁸ This section was authored by (name redacted), specialist in Macroeconomic Policy.

Section 928 of S. 1910⁵⁹ would give the banking regulators discretion to exempt any bank or thrift, at the subsidiary or holding company level, with less than \$10 billion in assets from any rule issued by the regulators or any provision of banking law. Regulators could exempt banks on the grounds that the provision or rule is unduly burdensome, is unnecessary to promote safety and soundness, and is in the public interest.

Policy Discussion. Currently, regulators consider whether tailoring and exemptions are permissible, required, or appropriate on a case-by-case basis; there is no blanket authority to offer tailoring or exemptions when the authority underlying a regulation does not allow it.⁶⁰ Granting regulators more discretion to provide tailoring or exemptions could be useful if it is believed that more specialized, technical expertise is required than Congress possesses to identify when policies are unduly burdensome or when exemptions would undermine the broad goals of regulation. Requiring regulators to consider whether regulations should be tailored or include exemptions could be desirable if Congress believes that regulators are insufficiently doing so at present.⁶¹ For example, proponents of H.R. 2896 and H.R. 5983 claim it is necessary because regulators are designing regulations for large banks and then applying them to small banks.⁶²

An alternative view is that regulatory relief involves policy trade-offs that Congress is better placed to make on a case-by-case basis than regulators. Granting regulators more discretion to provide tailoring or exemptions could result in more or less regulatory relief than Congress intended—indeed, it does not guarantee that any regulatory relief will occur. Critics view legislation as unnecessary because regulators have already provided tailoring or exemptions in many recent rules (although, as noted above, in some cases, statute does not allow it).⁶³ In some cases, by granting tailoring or exemptions, regulators would be overriding the will of Congress, who expressly declined to include tailoring or exemptions when provisions were originally enacted. A “look back” at existing regulations might also be time-consuming for regulators, and divert their attention from completing current initiatives.⁶⁴

CBO estimated that H.R. 2896 would increase direct spending by \$20 million in 2017, reduce revenues by \$24 million between 2017 to 2026, and would require additional appropriations of \$10 million over 2017 to 2021.⁶⁵

⁵⁹ This section is similar to S. 1799. It is the only provision of S. 1910 discussed in this report that was not originally part of S. 1484.

⁶⁰ In a recent speech, Fed Gov. Tarullo gave some examples of policies where he thought a size exemption might be warranted but the law did not permit it. Gov. Daniel Tarullo, “A Tiered Approach to Regulation and Supervision of Community Banks,” speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

⁶¹ Paul Kupiec, testimony before the House Financial Services Committee, October 21, 2015.

⁶² Independent Community Bankers of America, *Letter to the Honorable Jeb Hensarling and the Honorable Maxine Waters*, March 1, 2016, at <http://www.icba.org/files/ICBASites/PDFs/ltr030116.pdf>.

⁶³ Marcus Stanley, testimony before the House Financial Services Committee, October 21, 2015. For examples of tailoring and exemptions in recent rules, see CRS Report R43999, *An Analysis of the Regulatory Burden on Small Banks*, by (name redacted) and (name redacted).

⁶⁴ Consumer Federation of America, *Letter to House Financial Services Committee*, March 1, 2016, http://ourfinancialsecurity.org/wp-content/uploads/2016/03/160302_HR2896_oppose.pdf.

⁶⁵ CBO, *Cost Estimate: H.R. 2896, TAILOR Act, as ordered reported by the House Committee on Financial Services on March 2, 2016*, July 6, 2016, at <https://www.cbo.gov/publication/51782>.

Capital Treatment of Mortgage Servicing Assets (H.R. 1408, H.R. 2029, and S. 1484/S. 1910)⁶⁶

The Mortgage Servicing Asset Capital Requirements Act of 2015 (H.R. 1408) was agreed to by voice vote in the House on July 14, 2015. It was then included as Section 634 of Division E of the Consolidated Appropriations Act, 2016 (H.R. 2029), which was signed into law as P.L. 114-113 on December 18, 2015. Section 116 of S. 1484 (Section 917 of S. 1910) is also similar in content to H.R. 1408. The bills would require the federal banking regulators—the Fed, OCC, FDIC, and National Credit Union Administration (NCUA)—to “conduct a study of the appropriate capital requirements for mortgage servicing assets for banking institutions.”⁶⁷ H.R. 1408 as introduced would have delayed the implementation of Basel III for all but the largest institutions until the study was completed, but that provision was removed prior to House passage.

Mortgage Servicing Assets. Mortgage servicers collect payments from borrowers that are current and forward them to mortgage holders, work with borrowers that are delinquent to try to get them current, and extinguish mortgages (such as through foreclosures) if a borrower is in default. A mortgage servicer is compensated for its work. A mortgage holder can service the mortgage itself or hire an agent to act on its behalf. Just as the mortgage holder can sell the mortgage and the right to receive the stream of payments associated with a mortgage to a different investor, a servicer can sell to a different servicer the right to service a mortgage and to receive the compensation for doing so, which can make mortgage servicing a valuable asset. A *mortgage servicing asset* (MSA), therefore, is an asset that results “from contracts to service loans secured by real estate, where such loans are owned by third parties.”⁶⁸ Some banks will originate a mortgage and sell the mortgage to a different investor but retain the servicing of the mortgage (so they keep the MSA) to maintain their relationship with the customer.

Banks are required to fund their assets with a certain amount of capital to protect against the possibility that their assets may drop in value. The riskier an asset, the more capital a bank is required to hold to guard against losses. The Basel III framework is an international agreement with U.S. participation that includes guidelines on how banks should be regulated, such as how much capital they are required to hold against certain assets.⁶⁹ The federal bank regulators have issued rules generally implementing the Basel III framework and setting capital requirements that banks must follow.⁷⁰ Banks have identified the capital treatment for MSAs as one of the more costly aspects of the new capital requirements.

Policy Discussion. The new capital requirements mandate more capital for MSAs, making it more costly for banks to hold MSAs. As a result, some banks have started selling their MSAs and nonbanks (financial institutions that do not accept deposits and are not subject to the Basel III capital requirements) have purchased MSAs.⁷¹ Although the CFPB regulates nonbank mortgage

⁶⁶ This section was authored by Sean Hoskins, analyst in Financial Economics.

⁶⁷ H.R. 1408, §2.

⁶⁸ H.R. 1408, §2.

⁶⁹ For more on Basel, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by (name redacted). The National Credit Union Administration (NCUA) has a similar capital rule for credit unions. See NCUA, “Risk-Based Capital,” 80 *Federal Register* 17, January 27, 2015.

⁷⁰ Although banks have begun implementing the Basel III capital rules already, including the new mortgage servicing asset (MSA) treatment, the new treatment will not be fully phased in for several years. See Federal Reserve, OCC, “Regulatory Capital Rules,” 78 *Federal Register* 62079, October 11, 2013.

⁷¹ For more on the market shift to nonbank servicers, see Laurie Goodman and Pamela Lee, *OASIS: A Securitization Born from MSR Transfers*, Urban Institute, at <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/> (continued...)

servicers to ensure that they comply with consumer protections,⁷² some are worried that the growth of nonbank servicers and the sale of MSAs may “trigger a race to the bottom that puts homeowners at risk” as nonbank servicers cut costs to compete for business.⁷³

Given the concerns about the effect the Basel III capital requirements are having on the mortgage servicing market, some argue that “there needs to be additional review of whether or not additional capital is required simply for mortgage servicing.”⁷⁴ Supporters of additional review note that Basel III is an international agreement but that MSAs are a product of the U.S. housing finance system, which is different than the housing finance system in other countries. As a result, they contend that additional study needs to be given to this unique topic.⁷⁵

Some Members of Congress acknowledge that servicing has migrated to nonbanks and have expressed concerns about the implications of that migration. They have stated that they are generally supportive of having a study, but do not want the study to result in the delayed implementation of the Basel III requirements.⁷⁶ Critics of H.R. 1408 supported the removal of the provision in H.R. 1408 that would have delayed the implementation of Basel III for all but the largest institutions until the study was completed. They contend Basel III is important to the safety and soundness of the banking system.⁷⁷

CBO estimates that H.R. 1408 as ordered to be reported would affect direct spending and revenues but that “the net effect on the federal budget over the next 10 years would not be significant.”⁷⁸

Enhanced Regulation of Large Banks (H.R. 1309, H.R. 5983, H.R. 6392, S. 1484/S. 1910)⁷⁹

To address the “too big to fail” problem, Title I of the Dodd-Frank Act created an enhanced prudential regulatory regime for all large bank holding companies (BHCs) and non-bank SIFIs. Under Subtitle C of Title I, the Fed is the prudential regulator for any BHC with total consolidated assets of more than \$50 billion and any firm that the Financial Stability Oversight

(...continued)

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⁷² For more information, see CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by (name redacted) .

⁷³ Benjamin Lawskey, “Excerpts from Superintendent Lawskey’s Remarks on Non-Bank Mortgage Servicing in New York City,” May 20, 2014, at <http://www.dfs.ny.gov/about/press2014/pr1405201.htm>.

⁷⁴ Attributed to Rep. Ed Perlmutter by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation,” March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?9&search=M9QutUd4>.

⁷⁵ See American Bankers Association, “Letter to Representatives Luetkemeyer and Perlmutter,” May 12, 2014, at <http://www.aba.com/Advocacy/LetterstoCongress/Documents/ABALetteronMSAStop-StudyBill.pdf>.

⁷⁶ Attributed to Rep. Maxine Waters by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation,” March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?9&search=M9QutUd4>.

⁷⁷ CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation, March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?9&search=M9QutUd4>.

⁷⁸ CBO, *Cost Estimate of H.R. 1408*, April 9, 2015, at https://www.cbo.gov/sites/default/files/cbofiles/attachments/hr1408_1.pdf.

⁷⁹ This section was authored by (name redacted), specialist in Macroeconomic Policy.

Council (FSOC) has designated as a SIFI.⁸⁰ The Fed, with the FSOC's advice, is required to set safety and soundness standards that are more stringent than those applicable to other non-bank financial firms and BHCs that do not pose a systemic risk. There are currently about 30 U.S. BHCs with more than \$50 billion in consolidated assets.⁸¹

Section 201 of S. 1484 (Section 931 of S. 1910) would raise the asset threshold from \$50 billion to \$500 billion under which BHCs are automatically subject to Title I's enhanced prudential regulation by the Fed. For BHCs with assets between \$50 billion and \$500 billion, FSOC would have the authority to designate them as systemically important and thus subject to enhanced prudential regulation. Under current law, the asset threshold is fixed at \$50 billion, but FSOC and Fed have the discretion to raise it,⁸² whereas under S. 1484/S. 1910, these thresholds would be indexed annually based on the growth rate of GDP. For a BHC to be designated, at least two-thirds of FSOC voting members, including the chairman (the Treasury Secretary), would have to find that the BHC is systemically important based initially on five factors specified by the bill and a multi-step designation process laid out in the bill. As discussed below, a FSOC designation process is already used for non-bank financial firms; compared with statute governing the current non-bank designation process, S. 1484/S. 1910 would require FSOC to provide more information to (bank or non-bank) institutions and would give institutions more opportunities to take actions to avoid or reverse a SIFI designation. It would increase public disclosure requirements surrounding the designation process, including the identity of firms under consideration for designation.⁸³

S. 1484/S. 1910 would also amend provisions of the Dodd-Frank Act that apply to BHCs with more than \$50 billion in assets to apply instead to BHCs subject to the revised enhanced supervision (e.g., changing who is subject to emergency divestiture powers and to fees that finance enhanced regulation and the Office of Financial Research) Section 202 of S. 1484 (Section 932 of S. 1910) would increase the thresholds from \$10 billion to \$50 billion for requiring a BHC to form a risk committee (if the BHC is publicly traded) and conduct company-run stress tests. All of these thresholds would be indexed in future years based on GDP growth. These changes would become effective 180 days after enactment.

Section 506 of S. 1484 (Section 966 of S. 1910) would require GAO to conduct a study of the Fed's enhanced regulatory regime for banks and non-banks.

H.R. 1309 was ordered to be reported by the House Financial Services Committee on November 4, 2015. A similar bill, H.R. 6392, was referred to the House Financial Services Committee on November 22, 2016. The two bills would remove the \$50 billion asset threshold under which BHCs are automatically subject to Title I's enhanced prudential regulation by the Fed. If a bank has been designated as a "globally systemically important bank" (G-SIB) by the Financial

⁸⁰ The Financial Stability Oversight Council (FSOC) is a council of financial regulators, headed by the Treasury Secretary, that was created by the Dodd-Frank Act.

⁸¹ A current list of holding companies by asset size is available on the Federal Financial Institutions Examination Council's (FFIEC) list of "Holding Companies with Assets Greater Than \$10 Billion" at <https://www.ffiec.gov/nicpubweb/nicweb/HCSGreaterThan10B.aspx>. Some of the firms on this list are not bank holding companies. Savings and loan (thrift) holding companies with more than \$50 billion in assets are not subject to the final rule, but the Fed has indicated that it intends to propose rulemaking in the future that apply to them.

⁸² To date, the Fed and FSOC have not chosen to increase the threshold from \$50 billion.

⁸³ FSOC issued a rule in 2015 increasing the transparency of the non-bank designation process and permitting the company under consideration greater opportunities for input. For more information, see CRS Legal Sidebar WSLG1190, *FSOC Announces Rule Change to Increase Transparency in Designating SIFIs*, by (name redacted).

Stability Board, it would automatically be subject to enhanced prudential regulation.⁸⁴ As of November 2015, there are 30 G-SIBs, of which 8 are headquartered in the United States.⁸⁵ For BHCs that are not G-SIBs, FSOC would have the authority to designate them as systemically important, and thus subject to enhanced prudential regulation, under the designation process currently used for non-bank SIFIs. For a BHC to be designated, at least two-thirds of FSOC's voting members, including the Treasury Secretary, would have to find that it is systemically important using "the indicator-based measurement approach established by the Basel Committee...." The bill would provide a one-year phase-in period so that firms currently subject to enhanced regulation remain subject while the designation process is proceeding.

H.R. 1309 and H.R. 6392 would also modify other parts of the Dodd-Frank Act (e.g., banks subject to emergency divestiture powers and fees to finance enhanced regulation and the Office of Financial Research) that apply to BHCs with more than \$50 billion in assets to apply instead to banks subject to the revised enhanced supervision. Unlike H.R. 1309, H.R. 6392 would allow assessments to be levied on BHCs in the process of being considered for designation.

Section 211 of H.R. 5983 would repeal certain provisions of the Dodd-Frank Act that apply to banks with \$50 billion or more in assets, including early remediation requirements and emergency divestiture powers.⁸⁶ In addition, banks over \$50 billion that qualify to be subject to the 10% leverage ratio (discussed in the section entitled "Leverage Ratio as an Alternative to Current Bank Regulation (H.R. 5983)") would no longer be subject to enhanced prudential regulation (except stress tests) and other regulations based on financial stability considerations.

Background. The final rule implementing parts of Subtitle C for banks was adopted in February 2014, and banks were required to be in compliance by January 1, 2015.⁸⁷ The final rule includes requirements for stress tests run by the Fed, capital planning, liquidity standards, living wills, early remediation, and risk management. In the event that the FSOC has determined that it poses a "grave threat" to financial stability, the final rule also requires any bank with more than \$50 billion in assets to comply with a 15 to 1 debt to equity limit. Exposure limits of 25% of a company's capital per single counterparty were issued as a separate proposed rule that has not yet been finalized. Enhanced capital requirements have not been required of all BHCs with \$50 billion or more in assets; instead enhanced capital requirements for only the largest banks have been proposed or implemented through rules implementing Basel III.⁸⁸ This is an example of how there is already some "tiering" of regulation for large banks.⁸⁹

⁸⁴ Using G-SIB designation as the criteria for automatic U.S. designation could potentially lead to the designation of some foreign headquartered G-SIBs that are not currently subject to some of Dodd-Frank's enhanced regulations because they have less than \$50 billion in assets in U.S. banking entities. The Fed would then need to decide whether to apply some or all of the existing enhanced prudential regulations to the newly designated G-SIBs.

⁸⁵ Financial Stability Board, "2015 Update Of List Of Global Systemically Important Banks," <http://www.fsb.org/wp-content/uploads/2015-update-of-list-of-global-systemically-important-banks-G-SIBs.pdf>. The Financial Stability Board is an inter-governmental organization that monitors and develops standards for the global financial system.

⁸⁶ These provisions also apply to non-banks that have been designated as systemically important financial institutions by the FSOC.

⁸⁷ The rule, "Enhanced Prudential Standards for Bank Holding Companies and Foreign Banking Organizations," can be accessed at <http://federalreserve.gov/newsevents/press/bcreg/20140218a.htm>.

⁸⁸ For more information, see CRS Report R42150, *Systemically Important or "Too Big to Fail" Financial Institutions*, by (name redacted)

⁸⁹ For a detailed discussion of tiered regulation for large banks, see Daniel Tarullo, testimony before the Senate Banking Committee, March 19, 2015, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=2f189eda-33df-41e4-a2cd-a41c63d34499.

A large number of foreign banks operating in the United States are also subject to the enhanced prudential regime.⁹⁰ Foreign banks operating with more than \$50 billion in assets in the United States are required to set up intermediate BHCs that will be subject to heightened standards comparable to those applied to U.S. banks. Less stringent requirements apply to large foreign banks with less than \$50 billion in assets in the United States.

Policy Discussion. Critics of the \$50 billion asset threshold argue that many banks above that range are not systemically important. In particular, critics distinguish between “regional banks,” which tend to be at the lower end of the asset range and, it is claimed, have a traditional banking business model comparable to community banks, and “Wall Street banks,” a term applied to the largest, most complex organizations that tend to have significant non-bank financial activities.⁹¹ If critics are correct that some banks that are currently subject to enhanced prudential regulation are not systemically important, then there may be little societal benefit from subjecting them to enhanced regulation, making that regulation unduly burdensome to them. Alternatively, proponents view practices such as living wills, stress tests, and risk committees as “best practices” that any well-managed bank should follow to prudentially manage risk.⁹²

Many economists believe that the economic problem of “too big to fail” is really a problem of too complex or interdependent to fail. In other words, they believe policymakers are reluctant to allow a firm to fail if it is too complex to be wound down swiftly and orderly or if its failure would cause other firms to fail or would disrupt critical functions in financial markets. If firms and their creditors perceive policymakers as reluctant to allow the firms to fail, it creates incentives for those firms to take on excessive risk (known as “moral hazard”). These firms are referred to as systemically important.

Size correlates with complexity and interdependence, but not perfectly. It follows that a size threshold is unlikely to successfully capture all those—and only those—banks that are systemically important. A size threshold will capture some banks that are not systemically important if set too low or leave out some banks that are systemically important if set too high. (Alternatively, if policymakers believe that size is the paramount policy problem, then a numerical threshold is the best approach, although policymakers may debate the most appropriate number.) Size is a much simpler and more transparent metric than complexity or interdependence, however. Thus, policymakers face a trade-off between using a simple, transparent but imperfect proxy for systemic importance, or trying to better target enhanced regulation by evaluating banks on a case-by-case basis. A case-by-case designation process would be more time-consuming and resource-intensive, however. For example, only four non-banks were designated as SIFIs in three

⁹⁰ The Congressional Research Service was not able to locate an official list of banks subject to Title I enhanced supervision. In 2015, 31 BHCs were subject to the Title I Federal Reserve stress tests because they had over \$50 billion in assets. See Federal Reserve, *Dodd-Frank Act Stress Test 2015*, March 2015, <http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20150305a1.pdf>. About 130 banks (foreign and domestic) have submitted resolution plans (“living wills”) pursuant to Title I, however. See Chairman Martin Gruenberg, testimony before the Senate Committee on Banking, Housing, and Urban Affairs, September 9, 2014, p. 5, available at http://www.banking.senate.gov/public/index.cfm?FuseAction=Hearings.Testimony&Hearing_ID=b15fc832-df18-47d7-8c7d-1367e5770086&Witness_ID=c15856a4-8f8c-4958-ad7c-a385bb31c3f8.

⁹¹ See, for example, Deron Smithy, testimony before the Senate Banking Committee, March 24, 2015, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=14d286e0-9c50-4b96-87cf-fe999112550f. The argument that regional banks have a traditional business model has been disputed. See, for example, Simon Johnson, testimony before the Senate Banking Committee, March 24, 2015, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=14d286e0-9c50-4b96-87cf-fe999112550f.

⁹² Simon Johnson, testimony before the Senate Banking Committee, March 24, 2015, at http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=14d286e0-9c50-4b96-87cf-fe999112550f.

years under the existing process, and S. 1484/S. 1910 would add several additional formal steps to the process. Furthermore, there is no guarantee that FSOC will correctly identify systemically important BHCs since there is no definitive proof that a BHC is systemically important until it becomes distressed. Some fear that FSOC could make an incorrect judgment about a bank's systemic importance because most members of FSOC do not have banking expertise or because the Treasury Secretary has effective veto power.

Some Members of Congress have expressed concern about international agreements generally—and the Financial Stability Board's designations in particular—overriding domestic law in the areas of financial regulation. The G-SIB designation has not been referenced in an act of Congress, but some U.S. regulations have defined eligibility so that certain regulations apply only to banks with the G-SIB designation. H.R. 1309 and H.R. 6392 would enshrine G-SIB designation in U.S. statute.

CBO estimates that H.R. 1309 would increase the budget deficit by \$85 million over the 2017 to 2026 period.⁹³

The Dodd-Frank Act and the EGRPRA Process (S. 1484/S. 1910)⁹⁴

Section 125 of S. 1484 (Section 926 of S. 1910) would require the Dodd-Frank Act to be included in the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) review and would require the NCUA and the CFPB to also participate. Currently, the NCUA is not required to review its regulations under EGRPRA, but has elected to do so “in keeping with the spirit of the law.”⁹⁵ The CFPB is also not required to review its regulations through EGRPRA, but the “CFPB is required” by the Dodd-Frank Act “to review its significant rules and publish a report of its review no later than five years after they take effect.”⁹⁶

Background. Under EGRPRA,⁹⁷ the OCC, Federal Reserve, and FDIC are required to conduct a review at least every 10 years “to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions.”⁹⁸ The agencies began the latest review process by seeking public comment in June 2014. In this review, the agencies are placing an emphasis on reducing the regulatory burden on community banks.⁹⁹

Policy Discussion. Initially, the banking regulators decided that “new regulations that have only recently gone into effect, or rules that we have yet to fully implement” would not be included in

⁹³ Congressional Budget Office, *Cost Estimate: H.R. 1309 Systemic Risk Designation Improvement Act of 2015, as ordered reported by the House Committee on Financial Services on November 4, 2015*, May 31, 2016, at <https://www.cbo.gov/publication/51642>.

⁹⁴ This section was authored by Sean Hoskins, analyst in Financial Economics.

⁹⁵ NCUA, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 79 *Federal Register* 75763, December 19, 2014.

⁹⁶ OCC, Federal Reserve, FDIC, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 80 *Federal Register* 7980, February 13, 2015.

⁹⁷ P.L. 104-208, 12 U.S.C. §3311.

⁹⁸ OCC, Federal Reserve, FDIC, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 80 *Federal Register* 7980, February 13, 2015.

⁹⁹ OCC, Federal Reserve, FDIC, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 79 *Federal Register* 32173, June 4, 2014. Regulations under review can be found at FFIEC, “Regulations Under Review,” at <http://egrpra.ffiec.gov/regulations-under-review/regulations-under-review-index.html>. The previous report can be accessed at FFIEC, *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 30, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>.

the current EGRPRA review.¹⁰⁰ The agencies argued that they were already “required to take burden into account in adopting these regulations,” so including them in the EGRPRA process was unnecessary.¹⁰¹ The regulators, however, later “decided to expand the scope of the EGRPRA review to cover more recent regulations.”¹⁰² The legislation would codify this decision.

Some argue that the Dodd-Frank Act should not be included in the EGRPRA review because such “a review would be premature and unwise, as many Dodd-Frank Act reforms have not even been implemented, and those that are in place have had a very limited time to make the intended impact.”¹⁰³ If the Dodd-Frank regulations are to be included, critics contend that the “review should not be limited to the impact of regulation on regulated entities but must include a thorough analysis of the benefits of those rules collectively, including specifically the benefits of those rules in avoiding a future financial crisis and the costs, burdens, bailouts, and suffering that would accompany such a crisis.”¹⁰⁴

Supporters of the legislation argue that it is necessary to include the Dodd-Frank Act as well as the NCUA and the CFPB in the review in order to provide a more meaningful assessment of the regulatory burden facing financial institutions. In particular, they contend that the EGRPRA “review is only meaningful if we identify the biggest challenges for community banks and credit unions and provide real solutions.”¹⁰⁵

Municipal Bonds and the Liquidity Coverage Ratio (H.R. 2209)¹⁰⁶

H.R. 2209 passed the House on February 1, 2016. The bill would require any municipal bond “that is both liquid and readily marketable ... and investment grade” to be treated as a Level 2A high quality liquid asset for purposes of complying with the Liquidity Coverage Ratio (LCR) within three months of enactment. Municipal bonds are debt securities issued by state and local governments or public entities.¹⁰⁷ Members of Congress supporting H.R. 2209 have mainly voiced concern about the LCR’s impact on the ability of states and local governments to borrow, but because the LCR is applied to banks, H.R. 2209 would also have an effect on bank profitability and riskiness. CBO estimated that the bill would have a negligible effect on the federal budget.¹⁰⁸

¹⁰⁰ OCC, Federal Reserve, FDIC, “Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996,” 79 *Federal Register* 32174, June 4, 2014.

¹⁰¹ *Ibid.*

¹⁰² Federal Reserve, FDIC, OCC, “Agencies Announce Additional EGRPRA Outreach Meetings,” press release, April 6, 2015, at <http://www.federalreserve.gov/newsevents/press/bcreg/20150406a.htm>.

¹⁰³ Better Markets, *Regulatory Publication and Review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (“EGRPRA”)*, March 14, 2015, at http://www.federalreserve.gov/SECRS/2015/May/20150522/R-1510/R-1510%20_051415_129942_418572489457_1.pdf.

¹⁰⁴ *Ibid.*

¹⁰⁵ Sen. Mike Crapo, “Crapo: Dodd-Frank, CFPB Rules Must Be Included in 10-Year Regulatory Review,” press release, March 27, 2015, at http://www.crapo.senate.gov/media/newsreleases/release_full.cfm?id=358726.

¹⁰⁶ This section was authored by (name redacted), specialist in Macroeconomic Policy.

¹⁰⁷ For more information, see CRS Report R44146, *The Demand for Municipal Bonds: Issues for Congress*, by (name redacted) and (name redacted).

¹⁰⁸ CBO, *Cost Estimate: H.R. 2209 A bill to require the appropriate federal banking agencies to treat certain municipal obligations as level 2A liquid assets, and for other purposes, as ordered reported by the House Committee on Financial Services on November 4, 2015*, January 15, 2016, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr2209.pdf>.

Background. The banking regulators issued a final rule in 2014 that implements the LCR, which is part of bank liquidity standards required for large banks by Basel III and the Dodd-Frank Act.¹⁰⁹ In 2010, 27 countries agreed to modify the Basel Accords, which are internationally negotiated bank regulatory standards. In response to acute liquidity shortages and asset “fire sales” during the financial crisis, Basel III introduced international liquidity standards for the first time. The Dodd-Frank Act requires heightened prudential standards, including liquidity standards, for banks with more than \$50 billion in assets and non-banks that have been designated as SIFIs. The rule came into effect at the beginning of 2015 and will be fully phased in by the beginning of 2017.

The LCR applies to two sets of banks. A more stringent version (implementing Basel III) applies to the largest, internationally active banks, with at least \$250 billion in assets and \$10 billion in on-balance-sheet foreign exposure. A less stringent version (implementing the Dodd-Frank Act) applies to depositories with \$50 billion to \$250 billion in assets, except for those with significant insurance or commercial operations. Around 40 institutions must comply with the LCR, as of the end of 2015. The rule does not apply to credit unions, community banks, foreign banks operating in the United States, or non-bank SIFIs. Regulators plan to issue liquidity regulations at a later date for large foreign banks operating in the United States and non-bank SIFIs.

The LCR aims to require banks to hold enough “high-quality liquid assets” (HQLA) to match net cash outflows over 30 days in a hypothetical market stress scenario in which an unusual number of creditors are withdrawing substantial amounts of funds.¹¹⁰ An asset can qualify as a HQLA if it is less risky, has a high likelihood of remaining liquid during a crisis, is actively traded in secondary markets, is not subject to excessive price volatility, can be easily valued, and is accepted by the Fed as collateral for loans. HQLA must be “unencumbered”—for example, they cannot already be pledged as collateral in a loan. The assets that regulators have approved as HQLA include bank reserves, U.S. Treasury securities, certain securities issued by foreign governments and companies, securities issued by U.S. government-sponsored enterprises (GSEs), certain investment-grade corporate debt securities, and equities that are included in the Russell 1000 Index.

Different types of assets are relatively more or less liquid, and there is disagreement on how liquid assets need to be to qualify as HQLAs under the LCR. In the LCR, assets eligible as HQLA are assigned to one of three categories (Levels 1, 2A, and 2B). Assets assigned to the most liquid category (Level 1) receive more credit toward meeting the requirements, and assets in the least liquid category (Level 2B) receive less credit. For purposes of the LCR, Level 2A assets are subject to a 15% haircut (i.e., only 85% of their value counts toward meeting the LCR), whereas Level 2B assets are subject to a 50% haircut and may not exceed 15% of total HQLA.

In the 2014 final rule, municipal bonds did not qualify as HQLA to meet the LCR,¹¹¹ but a subsequent rule issued by the Fed and finalized on April 1, 2016, allows banks regulated by the Fed to count a limited amount of municipal debt as Level 2B HQLA for purposes of the LCR. According to the Fed,

¹⁰⁹ OCC, Federal Reserve, FDIC, “Liquidity Coverage Ratio,” 79 *Federal Register* 197, October 10, 2014, at <https://www.gpo.gov/fdsys/pkg/FR-2014-10-10/pdf/2014-22520.pdf>. For more information, see CRS In Focus IF10208, *The Liquidity Coverage Ratio (LCR)*, by (name redacted)

¹¹⁰ Outflows are measured net of inflows because market stress might cause funds to flow into a bank as well as flow out.

¹¹¹ The final rule differs from the Basel III agreement, which allowed some municipal bonds to count as Level 2A HQLA. OCC, Federal Reserve, FDIC, “Liquidity Coverage Ratio,” 79 *Federal Register* 197, October 10, 2014, p. 61463, at <https://www.gpo.gov/fdsys/pkg/FR-2014-10-10/pdf/2014-22520.pdf>.

The final rule allows investment-grade, U.S. general obligation state and municipal securities to be counted as HQLA up to certain levels if they meet the same liquidity criteria that currently apply to corporate debt securities. The limits on the amount of a state's or municipality's securities that could qualify are based on the liquidity characteristics of the securities.¹¹²

In the Fed's rule, the amount of municipal debt eligible to be included as HQLA is subject to various limitations, including an overall cap of 5% of a bank's total HQLA. Dedicated revenue bonds do not qualify as HQLA.¹¹³ The Fed requires banks to demonstrate that a security has "a proven record as a reliable source of liquidity in repurchase or sales markets during a period of significant stress" in order for it to qualify as HQLA.

The Fed's rule applies to institutions and holding companies regulated by the Fed. To date, the Office of the Comptroller of the Currency (OCC) and the FDIC have not issued similar proposed rules allowing municipal bonds to count as HQLA for banks for whom they are the primary regulators. Thus, proponents of H.R. 2209 argue that the Fed's proposed rule alone would not significantly mitigate the perceived impact of the LCR on municipal bonds.

Analysis. To the extent that the LCR reduces the demand for bank holding companies to hold municipal securities, it would be expected to increase the borrowing costs of states and municipalities. The impact of the LCR on the municipal bond market is limited by the fact that banks' holdings of municipal bonds are limited and relatively few banks are subject to the LCR.¹¹⁴ The Congressional Research Service (CRS) could not locate any data on the value of municipal securities held by banks subject to the LCR, but according to Federal Reserve data, all U.S. banks held about \$490 billion of municipal securities in the third quarter of 2015, equal to 13% of the total outstanding.¹¹⁵ Finally, even banks subject to the LCR are still allowed to hold municipal bonds, as long as they have a stable funding source to back their holdings.

Arguments that municipal bonds should qualify as HQLA because most pose little default risk confuses default risk, which is addressed by Basel's capital requirements, with liquidity risk, which is addressed by the LCR. The purpose of the LCR is to ensure that banks have ample assets that can be easily liquidated in a stress scenario; a municipal bond may pose very little default risk, but nevertheless be highly illiquid (i.e., hard to sell quickly). On the one hand, if the inclusion of assets that prove not to be liquid in the HQLA undermines the effectiveness of the LCR, it could increase the systemic risk posed by a large institution experiencing a run. On the other hand, further diversifying the types of assets that qualify as HQLA could reduce the risk stemming from any single asset class becoming illiquid.

If municipal bonds are included as HQLA, a challenge for regulators is how to differentiate between which municipal securities should or should not qualify. Some municipal securities are liquid in the sense that they are frequently traded, whereas others are not. According to data from the Municipal Securities Rulemaking Board, the 50 most actively traded municipal bond CUSIP (Committee on Uniform Securities Identification Procedures) numbers traded at least 1,970 times

¹¹² Federal Reserve, press release, April 1, 2016, at <http://www.federalreserve.gov/newsevents/press/bcreg/20160401a.htm>.

¹¹³ Dedicated revenue bonds are bonds issued by public entities that are repaid through a pre-identified stream of future revenues. Insured bonds are municipal bonds whose principal and interest has been insured by private firms. Insured bonds were not included as HQLA because several bond insurers failed during the financial crisis.

¹¹⁴ Demand could be further reduced if the rule is extended to non-bank SIFIs and foreign banks operating in the United States in the future.

¹¹⁵ Federal Reserve, *Financial Accounts of the United States*, December 10, 2015, Table L. 212, at <http://www.federalreserve.gov/releases/z1/current/z1.pdf>.

per year each, but even some of the largest CUSIPs traded less than 100 times a year in 2014.¹¹⁶ Proponents of including municipal debt as HQLA claim that some municipal securities are more liquid than some assets that currently qualify as HQLA, such as corporate debt.¹¹⁷ For purposes of the LCR, frequent trading may not be the only relevant characteristic of HQLA. For example, in the final rule, regulators argued that one reason why municipal bonds should not qualify as LCR is because banks cannot easily use them as collateral to access liquidity from repo (repurchase agreement) markets.¹¹⁸

In its final rule, the Fed did not provide an estimate of how many municipal securities would qualify as HQLA under the Fed's criteria. According to an estimate by the Securities Industry and Financial Markets Association of the impact of the proposed rule,

By one calculation, only \$186 billion of the nearly \$3.7 trillion of outstanding bonds would be eligible to be included as HQLA. While we recognize that the Fed seeks to ensure that only the most secure and liquid segment of the market is eligible for banks' LCR compliance, we do not believe that excluding 95 percent of the market strikes the right balance.¹¹⁹

The share of municipal securities that would qualify as HQLA under H.R. 2209 would depend on subsequent rulemaking. The Fed's rule differs from H.R. 2209 by classifying qualifying municipal bonds as Level 2B and Level 2A HQLA, respectively. The difference in treatment makes municipal bonds less attractive for purposes of the LCR in the Fed's rule relative to H.R. 2209. In comparing the Fed's rule to H.R. 2209, a key policy question is whether municipal bonds have more in common with the other Level 2A HQLA, which include securities issued by government sponsored enterprises and foreign governments, or the other Level 2B HQLA, which include corporate bonds and equities.

Small Bank Holding Company Policy Threshold (H.R. 3791, H.R. 5983)¹²⁰

H.R. 3791 passed the House on April 14, 2016. It was also included in Section 1126 of H.R. 5983. It would increase the threshold for BHCs and thrift holding companies (THCs) subject to the Federal Reserve's Small Bank Holding Company Policy Statement¹²¹ from those below \$1 billion to those below \$5 billion in assets. It would make a corresponding increase in the threshold for an institution to be exempted from the "Collins Amendment" to the Dodd-Frank Act. CBO estimated that the effects of the bill on direct spending and revenues would be "insignificant."¹²²

¹¹⁶ Municipal Securities Rulemaking Board, *2014 Fact Book*, 2015, pp. 23-24, at <http://www.msrb.org/msrb1/pdfs/MSRB-Fact-Book-2014.pdf>.

¹¹⁷ OCC, Federal Reserve, FDIC, "Liquidity Coverage Ratio," 79 *Federal Register* 197, October 10, 2014, p. 61462, at <https://www.gpo.gov/fdsys/pkg/FR-2014-10-10/pdf/2014-22520.pdf>.

¹¹⁸ OCC, Federal Reserve, FDIC, "Liquidity Coverage Ratio," 79 *Federal Register* 197, October 10, 2014, p. 61463, at <https://www.gpo.gov/fdsys/pkg/FR-2014-10-10/pdf/2014-22520.pdf>.

¹¹⁹ Securities Industry and Financial Markets Association, *Comment Letter*, July 24, 2015, at <http://www.cecouncil.com/media/245151/sifma-submits-comments-to-the-federal-reserve-system-on-the-liquidity-coverage-ratio-rule.pdf>.

¹²⁰ This section was authored by (name redacted), specialist in Macroeconomic Policy.

¹²¹ Appendix C to 12 C.F.R. §225.

¹²² CBO, *Cost Estimate: H.R. 3791 A bill to raise the consolidated assets threshold under the small bank holding company policy statement, and for other purposes, as ordered reported by the House Committee on Financial Services* (continued...)

Background. In general, the Fed limits the debt levels of BHCs and THCs to ensure that they are able to serve as a source of strength for their depository subsidiary. The Federal Reserve's Small Bank Holding Company Policy Statement is a regulation that allows BHCs and THCs that have less than \$1 billion in assets to hold more debt at the holding company level than would otherwise be permitted by capital requirements if the debt is used to finance up to 75% of an acquisition of another bank. To qualify, the holding company may not be engaged in significant nonbank activities, may not conduct significant off-balance-sheet activities, and may not have a substantial amount of outstanding debt or equity securities registered with the Securities and Exchange Commission (with the exception of trust preferred securities). After the acquisition, the holding company is required to gradually reduce its debt levels over several years, and it faces restrictions on paying dividends until the debt level is reduced. This policy is motivated by recognition of differences between how small and large banks typically finance acquisitions.

Although the policy statement is limited to making it easier to fund acquisitions through debt, it has also been referenced in other parts of banking regulation. Banks subject to the policy enjoy streamlined compliance with certain requirements.¹²³ More recently, all BHCs and THCs subject to the Small Bank Holding Company Policy Statement are exempted from the Collins Amendment (Section 171) to the Dodd-Frank Act,¹²⁴ which subjects holding companies to the same capital and leverage requirements as their depository subsidiaries. Holding companies subject to the policy statement are also exempted from the rule applying Basel III capital requirements at the holding company level (although their depository subsidiaries are still subject to this rule).¹²⁵

Since 1980, when the policy statement was issued, the threshold has been occasionally raised. Most recently, it was raised in the 113th Congress from \$500 million to \$1 billion and extended to cover savings and loan (thrift) holding companies by P.L. 113-250, which was signed into law on December 18, 2014. The Fed issued a final rule on April 9, 2015, implementing this statutory change.¹²⁶ The rule also extended the policy statement to apply to thrift holding companies.

Policy Discussion. Proponents view the legislation as providing well-targeted regulatory relief to banks with between \$1 billion and \$5 billion in assets. (As discussed previously, there is no consensus about whether banks of this size should be considered community banks.) Alternatively, the bill could be opposed on the grounds that providing relief based on size creates inefficient distortions in the allocation of credit or on the grounds that it weakens the ability of holding companies to act as a source of strength for affected banks.

(...continued)

on December 9, 2015, February 12, 2016, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr3791.pdf>.

¹²³ These requirements are discussed at Federal Reserve, "Small Bank Holding Company Policy Statement," 80 *Federal Register* 20156, April 15, 2015, at <https://www.gpo.gov/fdsys/pkg/FR-2015-04-15/pdf/2015-08513.pdf>.

¹²⁴ 12 U.S.C. §5371.

¹²⁵ OCC and Federal Reserve, "Regulatory Capital Rules," 78 *Federal Register* 62020, October 11, 2013, at <https://www.gpo.gov/fdsys/pkg/FR-2013-10-11/pdf/2013-21653.pdf>. For more information, see CRS Report R44573, *Overview of the Prudential Regulatory Framework for U.S. Banks: Basel III and the Dodd-Frank Act*, by (name redacted) .

¹²⁶ Federal Reserve, "Small Bank Holding Company Policy Statement," 80 *Federal Register* 20153, April 15, 2015, at <https://www.gpo.gov/fdsys/pkg/FR-2015-04-15/pdf/2015-08513.pdf>.

Optional Expanded Charter for Thrifts (H.R. 1660, H.R. 5983)¹²⁷

The Federal Savings Association Charter Flexibility Act of 2015 (H.R. 1660) was ordered to be reported by the House Committee on Financial Services on November 3, 2015. It was also included in Section 1151 of H.R. 5983. It would allow a federal savings association (also known as federal thrifts) to operate with the same rights and duties as a national bank without having to change its charter.

A federal thrift and a national bank are types of financial institutions that typically accept deposits and make loans but have different charters that allow for different permitted activities.

Historically, federal thrifts—which were established during the Great Depression when mortgage credit was tight—have focused on residential mortgage lending¹²⁸ and have faced restrictions in the other types of lending that they can perform. For example, federal thrifts are limited by statute¹²⁹ in the amount of commercial and non-residential real estate loans they can hold, whereas national banks do not face the same statutory restrictions.¹³⁰ Over time, the federal thrift charter has been expanded to allow federal thrifts to offer products similar to those offered by national banks, eroding some of the difference between the two.¹³¹

If a federal thrift wants to alter its business model and engage in activities that it is prohibited from performing but are allowed for a national bank, the federal thrift would have to convert its charter to a national bank charter, which can be a costly process. For federal thrifts that have mutual ownership structures, there would be a “need to convert to a stock form of ownership prior to converting to a national bank.”¹³² Supporters of H.R. 1660 argue that the proposal would provide federal thrifts “additional flexibility to adapt to changing economic conditions and business environments” by allowing a less costly process for expanding federal thrifts’ permitted activities without having to convert charters.¹³³ In addition, they argue that the change would not pose a safety and soundness risk because federal thrifts are regulated by the same regulator as national banks—the OCC regulates federal thrifts and national banks¹³⁴—and the bill would provide the OCC with authority to issue regulations as necessary to safeguard safety and soundness, ensuring that the switch would not pose undue risk. While there would be no change in regulator, the regulations and restrictions that apply to national banks would apply to federal thrifts that elected to make the change. The federal thrifts that elected to change, however, would maintain their corporate form and continue to be treated as federal thrifts for purposes of

¹²⁷ This section was authored by Sean Hoskins, analyst in Financial Economics.

¹²⁸ Under 12 U.S.C. § 1467a(m), federal savings associations are subject to a qualified thrift lender test that requires thrifts to hold qualified thrift investments.

¹²⁹ 12 U.S.C. § 1464(c)(2).

¹³⁰ For a comparison of the powers of national banks and federal savings associations, see OCC, *Summary of the Powers of National Banks and Federal Savings Associations*, August 31, 2011, at <http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/pub-other-fsa-nb-powers-chart.pdf>.

¹³¹ Simon Kwan, *Bank Charters vs. Thrift Charters*, Federal Reserve Bank of San Francisco, April 24, 1998, at <http://www.frbsf.org/economic-research/publications/economic-letter/1998/april/bank-charters-vs-thrift-charters/>.

¹³² OCC, *Conversions: Comptroller’s Licensing Manual*, April 2010, at <http://www.occ.treas.gov/publications/publications-by-type/licensing-manuals/conversi.pdf>.

¹³³ ABA, *Expand the Flexibility of the Federal Savings Charter to Grow and Serve Communities*, at <http://www.aba.com/Advocacy/Grassroots/Documents/HOLAFlexibility.pdf>.

¹³⁴ Until 2010, thrifts were regulated by the Office of Thrift Supervision, which was abolished by the Dodd-Frank Act.

“consolidation, merger, dissolution, conversion (including conversion to a stock bank or to another charter), conservatorship, and receivership.”¹³⁵

Others have raised issues with the bill being too narrowly focused and argue that it should also provide assistance to credit unions, which are another type of financial institution with a charter of permitted activities. Credit unions, for example, are limited in the amount of member business loans that they can hold.¹³⁶ Just as H.R. 1660 would expand the lending opportunities for thrifts, credit union supporters argue that credit unions’ lending opportunities should be expanded as well.¹³⁷

A broader issue underlying H.R. 1660 is whether the government should offer different charters, with different benefits and responsibilities, for businesses that engage in similar activities. Bills that narrow the differences between charter type arguably weaken the benefits of having different charters.

Mortgage and Consumer Protection Regulations

Banks are also regulated for consumer protection. These regulations are intended to ensure the safety of the products, such as loans, that banks offer to consumers.

Several bills would modify regulations issued by the Consumer Financial Protection Bureau, a regulator created by the Dodd-Frank Act to provide an increased regulatory emphasis on consumer protection. Prior to the Dodd-Frank Act, bank regulators were responsible for consumer protection. The Dodd-Frank Act gave the CFPB new authority and transferred existing authorities to it from the banking regulators. The Dodd-Frank Act also directed the CFPB to implement several new mortgage-related policy changes through rulemakings. The bills included in this section could be viewed in light of a broader policy debate about whether the CFPB has struck the appropriate balance between consumer protection and regulatory burden, and whether congressional action is needed to achieve a more desirable balance.

Manufactured Housing (H.R. 5983, H.R. 650, and S. 1484/S. 1910)¹³⁸

The Preserving Access to Manufactured Housing Act of 2015 (H.R. 650) was passed by the House on April 14, 2015. H.R. 650 as passed would affect the market for manufactured housing by amending the definitions of *mortgage originator* and *high-cost mortgage* in the Truth-in-Lending Act (TILA).¹³⁹ Sections 1101 and 1102 of H.R. 5983 and Section 108 of S. 1484 (Section 909 of S. 1910) contain provisions similar to H.R. 650.

Manufactured homes, which often are located in more rural areas, are a type of single-family housing that is factory built and transported to a placement site rather than constructed on-site.¹⁴⁰ When purchasing a manufactured home, a consumer does not necessarily have to own the land on which the manufactured home is placed. Instead, the consumer could lease the land, a practice

¹³⁵ H.R. 1660 §2.

¹³⁶ For more information, see CRS Report R43167, *Policy Issues Related to Credit Union Lending*, by (name redacted).

¹³⁷ Credit Union National Association, *Letter in Opposition to H.R. 1660*, November 2, 2015, at http://royce.house.gov/uploadedfiles/cuna_letter_on_hr_1660.pdf.

¹³⁸ This section was authored by Sean Hoskins, analyst in Financial Economics.

¹³⁹ 15 U.S.C. §§1601 et seq.

¹⁴⁰ Consumer Financial Protection Bureau (CFPB), *Manufactured-housing consumer finance in the United States*, September 2014, p. 9, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

that is different from what is often done with a site-built home.¹⁴¹ Manufactured housing also differs from site-built properties in other ways, such as which consumer protection laws apply to the transaction and how state laws title manufactured housing.¹⁴²

The Dodd-Frank Act changed the definitions for mortgage originator and high-cost mortgage to provide additional consumer protections to borrowers for most types of housing transactions, including manufactured housing. Some argue that these protections restrict credit for manufactured housing. The proposals would modify the definitions of mortgage originator and high-cost mortgage with the goal of increasing credit. Critics of the proposal are concerned about the effect on consumers of reducing the consumer protections. The first part of the proposals would not affect banks but would affect manufactured-home retailers. It is discussed briefly to provide context for the second part of the proposals, which would affect banks more directly.

Definition of Mortgage Originator. In response to problems in the mortgage market when the housing bubble burst, the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act)¹⁴³ and the Dodd-Frank Act established new requirements for mortgage originators' licensing, registration, compensation, training, and other practices. A mortgage originator is someone who, among other things, "(i) takes a residential mortgage loan application; (ii) assists a consumer in obtaining or applying to obtain a residential mortgage loan; or (iii) offers or negotiates terms of a residential mortgage loan."¹⁴⁴ The current definition in implementing the regulation excludes employees of manufactured-home retailers under certain circumstances, such as "if they do not take a consumer credit application, offer or negotiate credit terms, or advise a consumer on credit terms."¹⁴⁵ The legislation would expand the exception such that retailers of manufactured homes or their employees would not be considered mortgage originators unless they received more compensation for a sale that included a loan than for a sale that did not include a loan.

Policy Discussion. Supporters of the proposals argue that the current definition of mortgage originator is too broad and negatively affects the manufactured-housing market. Manufactured-home retailers "have been forced to stop providing technical assistance to consumers during the process of home buying" because of concerns that providing this assistance will result in the retailers being deemed loan originators, which in turn will lead to costs that the manufactured-home retailers do not want to bear, according to supporters.¹⁴⁶ Supporters of the bills argue that this situation has unnecessarily complicated the purchase process for consumers. The proposals would allow manufactured-home retailers to provide minimal assistance to consumers for which they would not be compensated.

Opponents of the proposals, however, note that the existing protections are intended to prevent retailers from pressuring consumers into making their purchase through a particular creditor.

¹⁴¹ According to the CFPB, about "three-fifths of manufactured-housing residents who own their home also own the land it is sited on." CFPB, *Manufactured-housing consumer finance in the United States*, September 2014, p. 6, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

¹⁴² For more, see CFPB, *Manufactured-housing consumer finance in the United States*, September 2014, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

¹⁴³ P.L. 110-289.

¹⁴⁴ P.L. 111-203, §1401. The definition of mortgage originator has multiple exemptions, such as for those who perform primarily clerical or administrative tasks in support of a mortgage originator or those who engage in certain forms of seller financing.

¹⁴⁵ CFPB, *Manufactured-housing consumer finance in the United States*, September 2014, p. 51, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

¹⁴⁶ Rep. Stephen Fincher, *Congressional Record*, vol. 161, part 53 (April 14, 2015), p. H2178.

Expanding the exemption, they argue, “would perpetuate the conflicts of interest and steering that plague this industry and allow lenders to pass additional costs on to consumers.”¹⁴⁷

High-Cost Mortgage. The proposals also would narrow the definition of high-cost mortgage for manufactured housing. A high-cost mortgage often is referred to as a “HOEPA loan” because the Home Ownership and Equity Protection Act (HOEPA)¹⁴⁸ provides additional consumer protections to borrowers for certain high-cost transactions involving a borrower’s home. The Dodd-Frank Act expanded the protections available to high-cost mortgages by having more types of mortgage transactions be covered and by lowering the thresholds at which a mortgage would be deemed high cost. The CFPB issued a rule implementing those changes in 2013.¹⁴⁹

Consumers receive additional protections on high-cost transactions, such as “special disclosure requirements and restrictions on loan terms, and borrowers in high-cost mortgages have enhanced remedies for violations of the law.”¹⁵⁰ Prior to originating the mortgage, lenders are required to receive “written certification that the consumer has obtained counseling on the advisability of the mortgage from a counselor that is approved to provide such counseling.”¹⁵¹ Because of these protections and the added legal liability associated with originating a high-cost mortgage, originating a HOEPA loan is generally considered more costly for a lender (which could be either a bank or a nonbank) than originating a non-HOEPA loan. This is an example of the trade-off between consumer protection and credit availability—if a loan is deemed high-cost, the consumer has added protections, but the lender may be less willing to originate it.

A mortgage is high cost if certain thresholds are breached related to the mortgage’s (1) annual percentage rate (APR) or (2) points and fees.¹⁵²

The APR is a measure of how much a loan costs expressed as an annualized rate. Computation of the APR includes the interest rate as well as certain fees, such as compensation to the lender and other expenses. Under the *APR test*, a loan is considered to be a high-cost mortgage if the APR exceeds the average prime offer rate (APOR, an estimate of the market mortgage rate based on a survey of rates) by more than 6.5 percentage points for most mortgages or by 8.5 percentage points for certain loans under \$50,000.¹⁵³ The bills would increase the threshold for the latter category to 10 percentage points above the APOR for certain transactions involving manufactured housing below \$75,000.

Points and fees, the second factor, refers to certain costs associated with originating the mortgage. The term *point* refers to compensation paid up front to the lender by the borrower. A point is expressed as a percentage of the loan amount, with one point equal to 1% of the loan amount.¹⁵⁴ The fees included in the definition of points and fees include prepayment penalties, certain types

¹⁴⁷ Corporation for Enterprise Development, “Consumer Groups Sign On Letter Opposing H.R. 650,” at http://cfed.org/assets/pdfs/policy/federal/consumer_groups_sign_on_letter_opposing_HR_650.pdf.

¹⁴⁸ P.L. 103-325.

¹⁴⁹ CFPB, “High-Cost Mortgage and Homeownership Counseling Amendments to the Truth in Lending Act (Regulation Z) and Homeownership Counseling Amendments to the Real Estate Settlement Procedures Act (Regulation X),” 78 *Federal Register* 6855, January 31, 2013.

¹⁵⁰ *Ibid.*, 6856.

¹⁵¹ 12 C.F.R. §1026.34.

¹⁵² In addition to the APR test and points and fees test, a mortgage can be high cost if there is a prepayment penalty that meets certain criteria, although that issue is not addressed by H.R. 650. See *Ibid.*

¹⁵³ 15 U.S.C. §1602(bb). Other thresholds apply to junior liens.

¹⁵⁴ In some cases, a point may be excluded from the definition of points and fees if the point results in a reduction in the interest rate that is charged to the borrower. See P.L. 111-203, §1412.

of insurance premiums, and other real estate-related fees. Under the *points and fees test*, the mortgage is high cost if the points and fees exceed (1) 5% of the total amount borrowed for most loans in excess of \$20,000 or (2) the lesser of 8% of the total amount or \$1,000 for loans of less than \$20,000.¹⁵⁵

The proposals would create a third category for the points and fees test for manufactured-housing loans. Under the third category, certain types of manufactured-housing transactions would be deemed high cost if the points and fees on loans less than \$75,000 were greater than 5% of the total loan amount or greater than \$3,000. This higher threshold would make it less likely that a manufactured-housing loan would be high-cost under the points and fees test, all else equal.

Policy Discussion. Data from the Consumer Financial Protection Bureau's September 2014 report on the manufactured-housing market indicate that manufactured-housing loans are more likely to be HOEPA loans than loans for traditional, site-built homes. The CFPB analyzed data for originations from 2012, which was before the more expansive Dodd-Frank definition of high-cost mortgage took effect. The CFPB estimated the share of the 2012 market that would have violated the APR test (which is just one of the high-cost triggers) had the current thresholds been in effect and found that "0.2 percent of all home-purchase loans in the U.S. have an interest rate that exceeds the HOEPA APR threshold. This fraction is only 0.01 percent for site-built homes but nearly 17 percent for manufactured homes."¹⁵⁶

As the CFPB notes, this estimate of the share of HOEPA loans may *understate* the true share because it does not include the points and fees test, but it also may *overstate* the true share because lenders may have adjusted the points, fees, interest rate, profitability of the loan, and other factors so that fewer loans would have been high-cost had the new thresholds been in effect.¹⁵⁷ Either way, the CFPB's data are illustrative of the fact that a larger share of manufactured-housing loans than site-built loans is likely to be affected by the high-cost mortgage requirements. The CFPB stated that the changes to HOEPA made by Dodd-Frank likely would lead to a larger share of all loans being high-cost, but "the resulting increase in the share of high-cost mortgages was much larger for manufactured-housing loans than for loans on site-built homes."¹⁵⁸

Manufactured-housing loans are more likely to be high-cost for several reasons. Manufactured-housing loans usually are smaller than loans for site-built properties. The CFPB's report found that the "median loan amount for site-built home purchase was \$176,000, more than three times the manufactured home purchase loan median of \$55,000."¹⁵⁹ Because manufactured-housing loans often are for a smaller amount, they are likely to have higher APR and points and fees ratios; the APR and points and fees computations include some fixed costs that do not vary proportionately to the size of the loan. All else equal, smaller loans would be more likely to breach the thresholds. To account for this, the APR test and the points and fees test have thresholds that vary based on the size of the loan, as explained above. Additionally, because of how some states title manufactured homes and other unique aspects of the manufactured-housing market, a manufactured-housing loan is likely to have a higher interest rate than a loan involving

¹⁵⁵ 15 U.S.C. § 1602(bb).

¹⁵⁶ CFPB, *Manufactured-housing consumer finance in the United States*, September 2014, pp. 35-36, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

¹⁵⁷ CFPB, *Manufactured-housing consumer finance in the United States*, September 2014, p. 48, at http://files.consumerfinance.gov/f/201409_cfpb_report_manufactured-housing.pdf.

¹⁵⁸ *Ibid.*, p. 48.

¹⁵⁹ *Ibid.*, p. 30.

a site-built home (all else equal), which makes it more likely that the loan will violate the APR threshold.¹⁶⁰

Supporters of the bills argue that the high-cost thresholds are poorly targeted for manufactured-housing loans because the fixed costs and higher rates associated with smaller manufactured-housing loans make it more likely that the thresholds will be exceeded.¹⁶¹ The existing adjustments for small-dollar loans are insufficient and allow too many manufactured-housing loans to be high-cost. As a result, critics of the current threshold argue, credit will be restricted as some lenders will be less inclined to bear the expense and liability associated with originating high-cost manufactured-housing loans. H.R. 650, they claim, is important for ensuring that credit is available for borrowers who want to purchase a manufactured home.

Opponents of the legislation argue that the APR and points and fees thresholds already are adjusted for the size of the loan and do not need to be further modified. Doing so would weaken consumer protections, they argue, for borrowers who are likely to have lower incomes and be more "economically vulnerable consumers."¹⁶² The Obama Administration has said that "if the President were presented with H.R. 650, his senior advisors would recommend that he veto the bill."¹⁶³

CBO estimates that H.R. 650 as ordered reported "would increase direct spending by less than \$500,000."¹⁶⁴ The bill would not affect revenues or discretionary spending.

Points and Fees (H.R. 685, H.R. 5983, and S. 1484/S. 1910)¹⁶⁵

The Mortgage Choice Act of 2015 (H.R. 685) was passed by the House on April 14, 2015. H.R. 685 as passed would modify the definition of points and fees to exclude from the definition (1) insurance held in escrow and (2) certain fees paid to affiliates of the lender. Section 1106 of H.R. 5983 includes a similar provision. S. 1484 and S. 1910 would also exclude insurance held in escrow from the definition of points and fees, but would not exclude fees paid to affiliates. Instead, Section 107 of S. 1484 (Section 908 of S. 1910) would require a study and report that would examine the effect of the Dodd-Frank Act on the ability of affiliated lenders to provide mortgage credit, on the mortgage market for mortgages that are not qualified mortgages, on the ability of prospective homeowners to obtain financing, and several other issues.

As is elaborated upon below, points and fees refers to certain costs that are paid by the borrower related to lender compensation and other expenses that are associated with originating the mortgage. How points and fees are defined can have an effect on *credit availability* (mortgage lenders argue that the current definition of points and fees makes it harder for them to extend credit) and an effect on *consumer protection* (consumer groups argue that expanding the

¹⁶⁰ Ibid., p. 6.

¹⁶¹ Manufactured Housing Institute, "The Preserving Access to Manufactured Housing Act (S. 682/H.R. 650)," at <http://www.manufacturedhousing.org/webdocs/S%20682%20HR%20650%20leave%20behind%20use.pdf>.

¹⁶² Executive Office of the President, *Statement of Administration Policy: H.R. 650—Preserving Access to Manufactured Housing Act of 2015*, April 13, 2015, at https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr650r_20150413.pdf.

¹⁶³ Ibid.

¹⁶⁴ CBO, *Cost Estimate H.R. 650: Preserving Access to Manufactured Housing Act of 2015, as ordered reported by the House Committee on Financial Services on March 26, 2015*, April 3, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr650.pdf>.

¹⁶⁵ This section was authored by Sean Hoskins, analyst in Financial Economics.

definition could lead to borrowers being steered into more expensive mortgages that they could be less able to repay).

The Ability-to-Repay Rule and Points and Fees. The definition of points and fees is a component of multiple rules, but it is often discussed in the context of the Ability-to-Repay (ATR) rule.¹⁶⁶ Title XIV of the Dodd-Frank Act established the ATR requirement and instructed the CFPB to establish the definition of a qualified mortgage (QM) as part of its implementation. The ATR rule requires a lender to determine, based on documented and verified information, that at the time a mortgage loan is made the borrower has the ability to repay the loan. Failure to make such a determination could result in a lender having to pay damages to a borrower who brings a lawsuit claiming that the lender did not follow the ATR rule. This legal risk gives lenders added incentive to comply with the ATR rule.

One of the ways a lender can comply with the ATR rule is by originating a QM.¹⁶⁷ A QM is a mortgage that satisfies certain underwriting and product-feature requirements, such as having payments below specified debt-to-income ratios and having a term no longer than 30 years. By making a QM, a lender is presumed to have complied with the ATR rule and receives legal protections that could reduce its potential legal liability. A lender can comply with the ATR rule by making a mortgage that is not a QM, but the lender will not receive the additional legal protections. The definition of a QM, therefore, is important to a lender seeking to minimize its legal risk. Because of this legal risk, some are concerned that, at least in the short term, the vast majority of mortgages that are originated will be mortgages meeting the QM standards due to the legal protections that QMs afford lenders, even though there are other means of complying with the ATR rule.¹⁶⁸

As an additional requirement for a mortgage to be a QM, certain points and fees associated with the mortgage must be below specified thresholds. Some argue that the more types of fees that are included in the QM rule's definition of points and fees, the more likely a mortgage is to breach the points and fees threshold and no longer qualify as a QM.¹⁶⁹ The definition of points and fees, therefore, may be important for determining whether a mortgage receives QM status, which can influence whether the lender will extend the loan.

The points and fees threshold varies based on the size of the loan. The threshold is higher for smaller loans because some fees are fixed costs that do not depend on the size of the loan. All else equal, smaller loans would be more likely to breach the thresholds unless their thresholds were higher. The thresholds, which are indexed for inflation, are currently as follows:

- 3% of the total loan amount for a loan greater than or equal to \$100,000;
- \$3,000 for a loan less than \$100,000 but greater than or equal to \$60,000;

¹⁶⁶ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6407, January 30, 2013. For more on the rule, see CRS Report R43081, *The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues*, by (name redacted) .

¹⁶⁷ For the definition of a QM, see 12 C.F.R. §1026.43.

¹⁶⁸ CFPB, Prepared remarks of Richard Cordray at a meeting of the Credit Union National Association, February 27, 2013, at <http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-credit-union-national-association/>. For a preliminary analysis of the effect of the QM rule on originations, see Bing Bai, *Data show surprisingly little impact of new mortgage rules*, Urban Institute, August 21, 2014, at <http://www.urban.org/urban-wire/data-show-surprisingly-little-impact-new-mortgage-rules>.

¹⁶⁹ It is possible, however, that the market may adapt and have new fees so that the current definition may not affect future outcomes.

- 5% of the total amount for a loan less than \$60,000 but greater than or equal to \$20,000;
- \$1,000 for a loan less than \$20,000 but greater than or equal to \$12,500; and
- 8% of the total loan amount for a loan less than \$12,500.¹⁷⁰

A loan that is above the respective points and fees cap cannot be a QM.

The definition of points and fees includes certain costs associated with originating the mortgage. The term *point* refers to compensation paid up front to the lender by the borrower. A point is expressed as a percentage of the loan amount, with one point equal to 1% of the loan amount.¹⁷¹ The definition of *fees* has several different categories of fees, but what is most pertinent with respect to H.R. 685 is that certain fees are excluded from the definition of points and fees if “the charge is paid to a third party unaffiliated with the creditor.”¹⁷² Certain fees paid to third parties affiliated¹⁷³ with the lender are included in the definition. H.R. 685 and H.R. 5983 would change the treatment of fees for third parties affiliated with the lender by allowing (in some cases) those fees to also be excluded from the definition of points and fees. S. 1484 and S. 1910 would not exclude fees for third parties affiliated with the lender from the definition of points and fees, but would require a study that would examine the issue.

Policy Discussion. As mentioned above, the legislative proposals address the treatment of several types of fees. However, most of the policy debate surrounding fees for affiliated entities has focused on title insurance because title insurance is one of the larger fees associated with a mortgage that would be affected by the changes H.R. 685 and H.R. 5983 propose to the points and fees definition.¹⁷⁴ Title insurance involves “searching the property’s records to ensure that [a particular individual is] the rightful owner and to check for liens.”¹⁷⁵ Title insurance provides protection to the lender or borrower (depending on the type of policy) if there turns out to be a defect in the title. Under the current definition for points and fees, fees for title insurance provided by a title insurer that is independent of or unaffiliated with the lender may be *excluded* from the points and fees definition, but the fees for an affiliated title insurer must be *included* in the definition of points and fees. H.R. 685 and H.R. 5983 would allow fees for affiliated title insurance to be treated the same as independent title insurance, and both would be excluded from the points and fees definition.

The cap on points and fees is intended to protect consumers from predatory loans by limiting fees that can be placed on a QM and by aligning the incentives of the lender and the borrower. Lenders can be compensated through points that are paid up front or through interest payments

¹⁷⁰ CFPB, “Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act,” 78 *Federal Register* 6587, January 30, 2013.

¹⁷¹ In some cases, a point may be excluded from the definition of points and fees if the point results in a reduction in the interest rate that is charged to the borrower. See P.L. 111-203, §1412.

¹⁷² 15 U.S.C. §1602(bb).

¹⁷³ An affiliated business arrangement is “an arrangement in which (A) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of such person, has either an affiliate relationship with or a direct or beneficial ownership interest of more than 1 percent in a provider of settlement services; and (B) either of such persons directly or indirectly refers such business to that provider or affirmatively influences the selection of that provider.” See 12 U.S.C. §2602(7).

¹⁷⁴ CFPB, “Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act,” 78 *Federal Register* 6439, January 30, 2013.

¹⁷⁵ Federal Reserve, “A Consumer’s Guide to Mortgage Refinancings,” at <http://www.federalreserve.gov/pubs/refinancings/>.

over the life of the loan. The method by which the lender receives compensation may influence the lender's incentive to evaluate the borrower's ability to repay the mortgage. As the CFPB notes in its preamble to the ATR rule, the cap on points and fees may make lenders "take more care in originating a loan when more of the return derives from performance over time (interest payments) rather [than] from upfront payments (points and fees). As such, this provision [the cap on points and fees] may offer lenders more incentive to underwrite these loans carefully."¹⁷⁶

Supporters of H.R. 685 and H.R. 5983 argue that expanding the definition of points and fees is important to ensuring that credit is available. The Mortgage Bankers Association, for example, stated that as a result of the current definition of points and fees, "many affiliated loans, particularly those made to low-and moderate-income borrowers, would not qualify as QMs and would be unlikely to be made or would only be available at higher rates due to heightened liability risks. Consumers would lose the ability to choose to take advantage of the convenience and market efficiencies offered by one-stop shopping."¹⁷⁷ Putting the fees of affiliated and independent title insurers on equal footing in the points and fees definition, supporters argue, would enhance competition in the title insurance industry.¹⁷⁸

Supporters also contend that because title insurance is regulated predominantly by the states and many states have policies in place to determine how title insurance is priced, there is less need to be concerned that title insurance fees are excessive.¹⁷⁹ They note that the Real Estate Settlement Procedures Act (RESPA)¹⁸⁰ allows affiliated business arrangements and already has protections in place for consumers, such as "a requirement to disclose affiliation to consumers."¹⁸¹

Opponents of H.R. 685 and H.R. 5983 argue that, by narrowing the definition of points and fees to exclude affiliated providers, the bill "would allow lenders to increase the cost of loans and still be eligible for 'Qualified Mortgage' treatment. This revision risks eroding consumer protections and returning the mortgage market to the days of careless lending focused on short-term profits."¹⁸² For this reason, the Obama Administration has said that "if the President were presented with H.R. 685, his senior advisors would recommend that he veto the bill."¹⁸³

Critics also contend that removing affiliated title insurers from the points and fees definition would reduce the title insurance industry's incentive to make the price of title insurance, which some believe is already too high, "more reasonable."¹⁸⁴ They note that affiliated service providers are likely to be able to receive business through references from their affiliate and, therefore,

¹⁷⁶ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6562, January 30, 2013.

¹⁷⁷ Letter from Mortgage Bankers Association, April 13, 2015, at <http://mba.informz.net/MBA/data/images/HR685Leadership4132015.pdf>.

¹⁷⁸ *Ibid.*

¹⁷⁹ The Realty Alliance, "Congress Should Pass the Mortgage Choice Act," at <http://www.therealtyalliance.com/getpublicfile.asp?ref=41>.

¹⁸⁰ 12 U.S.C. §§2601 et seq.

¹⁸¹ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6438, January 30, 2013.

¹⁸² Executive Office of the President, *Statement of Administration Policy: H.R. 685—Mortgage Choice Act of 2015*, April 13, 2015, at https://www.whitehouse.gov/sites/default/files/omb/legislative/sap/114/saphr685r_20150413.pdf.

¹⁸³ *Ibid.*

¹⁸⁴ Center for Responsible Lending, "H.R. 685 Will Lead to Higher Fees for Homebuyers," at http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2015/04/hr685_will_lead_to_higher_fees_for_homebuyers-fact-sheet-3.18.15.pdf.

"affiliates of a creditor may not have to compete in the market with other providers of a service and thus may charge higher prices that get passed on to the consumer."¹⁸⁵

Escrow. H.R. 685, H.R. 5983, S. 1484, and S. 1910 would modify the definition of points and fees to exclude from the definition insurance held in escrow. Supporters of the proposals state that the bill would clarify that insurance held in escrow¹⁸⁶ should not be included in the definition of points and fees.¹⁸⁷ They argue that the drafting of the Dodd-Frank Act left unclear how insurance payments held in escrow should be treated in the definition. Opponents of the proposals have not cited this provision as a rationale for their opposition.

CBO estimates that H.R. 685 as ordered reported "would affect direct spending" but that "those effects would be insignificant."¹⁸⁸ The bill would not affect revenues or discretionary spending, according to CBO.

Rural Lending (H.R. 22, H.R. 1259 and S. 1484/S. 1910)¹⁸⁹

The Helping Expand Lending Practices in Rural Communities Act (H.R. 1259) was passed by the House on April 13, 2015. H.R. 1259 as passed would establish a temporary, two-year program in which individuals could petition the CFPB for counties that were not designated as rural by the CFPB to receive the rural designation. It also would establish evaluation criteria and an evaluation process for the CFPB to follow in assessing these petitions. A similar provision was included in the Fixing America's Surface Transportation Act (H.R. 22/P.L. 114-94). Section 103 of S. 1484 (Section 904 of S. 1910) would establish a petition process similar to the one proposed by H.R. 1259, but the process under S. 1484 and S. 1910 would not sunset after two years. The legislative proposals could increase the credit available to borrowers in rural areas but would reduce some of the protections put in place for rural consumers.

Definition of Rural. Statute allows for exemptions from certain consumer protection requirements for companies operating in rural areas. In implementing the requirements, the CFPB designates certain counties as rural. The exemptions and additional compliance options for lenders in rural areas stem from concerns that borrowers in these areas may have a harder time accessing credit than those in non-rural areas. For example, the ATR rule has an additional compliance option that allows small lenders operating in rural or underserved areas to originate balloon mortgages, subject to some restrictions.¹⁹⁰

The Dodd-Frank Act specifies the additional compliance option for rural lenders, but it leaves the definition of rural to the discretion of the CFPB. Balloon mortgages originated by lenders in areas that are not designated as rural may be ineligible for the compliance option (although the CFPB

¹⁸⁵ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6439, January 30, 2013.

¹⁸⁶ An *escrow* account is an account that a "mortgage lender may set up to pay certain recurring property-related expense ... such as property taxes and homeowner's insurance." Property taxes and homeowner's insurance are often lump-sum payments owed annually or semiannually. See CFPB, "What is an escrow or impound account?," at <http://www.consumerfinance.gov/askcfpb/140/what-is-an-escrow-or-impound-account.html>.

¹⁸⁷ The Realty Alliance, "Congress Should Pass the Mortgage Choice Act," at <http://www.therealtyalliance.com/getpublicfile.asp?ref=41>.

¹⁸⁸ CBO, *Cost Estimate of H.R. 685*, April 3, 2015, at https://www.cbo.gov/sites/default/files/cbofiles/attachments/hr_685.pdf.

¹⁸⁹ This section was authored by Sean Hoskins, analyst in Financial Economics.

¹⁹⁰ See 12 C.F.R. §1026.43 and see CRS Report R43081, *The Ability-to-Repay Rule: Possible Effects of the Qualified Mortgage Definition on Credit Availability and Other Selected Issues*, by (name redacted) .

has established a two-year transition period to allow "small"¹⁹¹ lenders to originate balloon mortgages until January 2016, subject to some restrictions). Lenders that benefit from exemptions may offer products to their consumers that lenders in non-rural areas may be less likely to offer, but consumers in rural areas may not receive the same protections as those in non-rural areas.

When publishing the ATR rule, the CFPB stated that it considers its method of designating counties as rural, which is based on the U.S. Department of Agriculture's Urban Influence Codes,¹⁹² to be consistent with the intent of the exemptions contained in statute. The CFPB estimated that its definition of rural results in 9.7% of the total U.S. population being in rural areas.¹⁹³ However, in light of various questions about its definition of rural raised during the comment period, the CFPB said in 2013 that it intended "to study whether the [definition] of 'rural' ... should be adjusted."¹⁹⁴ As a result, the CFPB issued a rule in September 2015 to expand the definition of rural as a means of facilitating access to credit in rural areas.¹⁹⁵ The new definition would have two prongs: an area could be deemed rural under the existing methodology involving the Urban Influence Codes or, if it is not designated as rural by that test, it could qualify under an alternative method that involves the Census Bureau's census block data.

To qualify for some of the exemptions, a lender not only must operate in a rural area but also must meet the CFPB's definition of small, which the CFPB also expanded in its September 2015 rule. Based on 2013 data, the CFPB estimates "that the number of rural small creditors would increase from about 2,400 to about 4,100."¹⁹⁶

Policy Discussion. Although the rule is intended to expand credit availability, the CFPB notes that its analysis "did not find specific evidence that the final provisions would increase access to credit."¹⁹⁷ The CFPB explains that its inability to estimate the change in credit availability from the rule may be due to data limitations that prevent it from testing certain hypotheses.¹⁹⁸ Alternatively, the CFPB notes that the change in credit availability may be difficult to estimate because borrowers in rural areas already may be adequately served by lenders and therefore may not benefit from the CFPB's expanded definition.¹⁹⁹

The CFPB maintains that the use of census blocks, as suggested in its rule, allows for a more granular approach, but critics have argued that the new approach "is still inadequate because

¹⁹¹ The CFPB originally defined small for the purpose of the ATR rule as having less than or equal to \$2 billion in assets and originating 500 or fewer mortgages in the previous year. The September 2015 rule, among other things, raised the threshold to 2,000 mortgage loans. See CFPB, "CFPB Finalizes Rule to Facilitate Access to Credit in Rural and Underserved Areas," September 21, 2015, at <http://www.consumerfinance.gov/newsroom/cfpb-finalizes-rule-to-facilitate-access-to-credit-in-rural-and-underserved-areas/>.

¹⁹² For the definition of rural, see 12 C.F.R. §1026.35.

¹⁹³ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6543, January 30, 2013.

¹⁹⁴ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 6, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

¹⁹⁵ CFPB, "CFPB Finalizes Rule to Facilitate Access to Credit in Rural and Underserved Areas," September 21, 2015, at <http://www.consumerfinance.gov/newsroom/cfpb-finalizes-rule-to-facilitate-access-to-credit-in-rural-and-underserved-areas/>.

¹⁹⁶ CFPB, "Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)," p. 73, at http://files.consumerfinance.gov/f/201509_cfpb_amendments-relating-to-small-creditors-and-rural-or-underserved-areas-under-the-truth-in-lending-act-regulation-z.pdf.

¹⁹⁷ *Ibid.*, p. 76.

¹⁹⁸ *Ibid.*, p. 77.

¹⁹⁹ *Ibid.*, p. 77.

census tracts are only updated once every 10 years.”²⁰⁰ Supporters of the proposals contend the CFPB’s method of designating counties as rural is inflexible and may not account for “atypical population distributions or geographic boundaries.”²⁰¹ The proposals are intended, supporters argue, to provide a way to challenge a CFPB designation and invite individuals “to participate in their government and provide input on matters of local knowledge. It is about making the Federal Government more accessible, more accountable, and more responsive to the people who know their local communities best.”²⁰²

CBO estimates that H.R. 1259 as ordered reported would increase direct spending by \$1 million over the next 10 years but would not affect revenues or discretionary spending.²⁰³

Mortgage Escrow and Servicing (H.R. 1529 and H.R. 5983)²⁰⁴

The Community Institution Mortgage Relief Act of 2015 (H.R. 1529) was reported by the House Committee on Financial Services on April 6, 2015. H.R. 1529 as reported would make two modifications to CFPB mortgage rules. It would (1) exempt from certain escrow requirements any mortgage held by a lender with assets of \$10 billion or less if the mortgage is held in the lender’s portfolio for three years and (2) exempt from certain servicing requirements any servicer that annually services 20,000 mortgages or fewer. Section 1131 of H.R. 5983 contains nearly identical language as H.R. 1529. Supporters of H.R. 1529 and H.R. 5983 argue that the provisions would reduce the burden on small lenders and servicers of complying with these regulations while giving added flexibility to consumers. Opponents argue that the bills would roll back consumer protections that were put in place in response to the housing and foreclosure crisis.

Escrow Accounts. An *escrow* account is an account that a “mortgage lender may set up to pay certain recurring property-related expenses ... such as property taxes and homeowner’s insurance.”²⁰⁵ Property taxes and homeowner’s insurance often are lump-sum payments owed annually or semiannually. To ensure a borrower has enough money to make these payments, a lender may divide up the amount owed and add it to a borrower’s monthly payment. The additional amount paid each month is placed in the escrow account and then drawn on by the mortgage servicer that administers the account to make the required annual or semiannual payments. Maintaining escrow accounts for borrowers is an additional cost to banks and may be especially costly for smaller firms.

An escrow account is not required for all types of mortgages but had been required for at least one year for higher-priced mortgage loans even before the Dodd-Frank Act.²⁰⁶ A *higher-priced mortgage loan* is a loan with an APR “that exceeds an ‘average prime offer rate’²⁰⁷ for a

²⁰⁰ Rep. Andy Barr, *Congressional Record*, vol. 161, part 52 (April 13, 2015), p. H2121.

²⁰¹ Conference of State Bank Supervisors, “Letter of Support for H.R. 2672,” December 4, 2013, at <http://www.csbs.org/legislative/Documents/CSBSLetterofSupportforHR2672Dec42013.pdf>.

²⁰² Rep. Andy Barr, *Congressional Record*, vol. 161, part 52 (April 13, 2015), p. H2121.

²⁰³ CBO, *Cost Estimate: H.R. 1259 Helping Expand Lending Practices in Rural Communities Act, as ordered reported by the House Committee on Financial Services on March 26, 2015*, April 6, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr-1259.pdf>.

²⁰⁴ This section was authored by Sean Hoskins, analyst in Financial Economics.

²⁰⁵ CFPB, “What is an escrow or impound account?,” at <http://www.consumerfinance.gov/askcfpb/140/what-is-an-escrow-or-impound-account.html>.

²⁰⁶ A higher-priced mortgage loan is different from a high-cost mortgage described in H.R. 650. (See “Manufactured Housing.”)

²⁰⁷ The average prime offer rate (APOR) is an estimate of the market mortgage rate based on a survey of rates. The (continued...)

comparable transaction by 1.5 or more percentage points for transactions secured by a first lien, or by 3.5 or more percentage points for transactions secured by a subordinate lien."²⁰⁸ If the first lien is a *jumbo mortgage* (above the conforming loan limit²⁰⁹ for Fannie Mae and Freddie Mac), then it is considered a higher-priced mortgage loan if its APR is 2.5 percentage points or more above the average prime offer rate. The Dodd-Frank Act, among other things, extended the amount of time an escrow account for a higher-priced mortgage loan must be maintained from one year to five years, although the escrow account can be terminated after five years only if certain conditions are met. It also provided additional disclosure requirements.²¹⁰

The Dodd-Frank Act gave the CFPB the discretion to exempt from certain escrow requirements lenders operating predominantly in rural areas if the lenders satisfied certain conditions.²¹¹ The CFPB's escrow rule included exemptions from escrow requirements for lenders that (1) operate predominantly in rural or underserved areas; (2) extend 2,000 mortgages or fewer; (3) have less than \$2 billion in total assets; and (4) do not escrow for any mortgage they service (with some exceptions).²¹² Additionally, a lender that satisfies the above criteria must intend to hold the loan in its portfolio to be exempt from the escrow requirement for that loan. H.R. 1529 would expand the exemption such that a lender also would be exempt from maintaining an escrow account for a mortgage as long as it satisfied two criteria: (1) the mortgage is held by the lender in its portfolio for three or more years and (2) the lender has \$10 billion or less in assets.

Policy Discussion. When the CFPB issued its escrow rule in January 2013, it estimated that "there are 2,612 exempt creditors who originated ... first-lien higher-priced mortgage loans in 2011."²¹³ It also estimated that there would be 5,087 lenders with \$10 billion or less in total assets who, collectively, originated 91,142 first-lien higher-priced mortgage loans in 2011 that would *not* be exempt from the escrow requirements.²¹⁴ If H.R. 1529 had been in place in 2011, those additional 5,087 lenders would have been exempt from the escrow requirements for the loans held in portfolio for three or more years.²¹⁵

(...continued)

CFPB will publish the APOR weekly.

²⁰⁸ CFPB, "Escrow Requirements Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 4726, January 22, 2013.

²⁰⁹ See CRS Report RS22172, *The Conforming Loan Limit*, by (name redacted) and (name redacted)

²¹⁰ CFPB, *Small Entity Compliance Guide: TILA Escrow Rule*, April 18, 2013, p. 4, at http://files.consumerfinance.gov/f/201307_cfpb_updated-sticker_escrows-implementation-guide.pdf.

²¹¹ P.L. 111-203, §1461.

²¹² See 12 C.F.R. §1026.35 and CFPB, "Escrow Requirements Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 4726, January 22, 2013. The CFPB's September 2015 rule also the escrow requirements, see CFPB, "Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)," at http://files.consumerfinance.gov/f/201509_cfpb_amendments-relating-to-small-creditors-and-rural-or-underserved-areas-under-the-truth-in-lending-act-regulation-z.pdf.

²¹³ CFPB, "Escrow Requirements Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 4747, January 22, 2013. The data the CFPB uses do not include non-depository institutions, so the CFPB estimates are a lower bound.

²¹⁴ *Ibid.*, p. 4748.

²¹⁵ The CFPB expanded its definitions of small and rural, allowing more lenders to be deemed small and areas to be deemed rural. With this change, there would be more small lenders in rural areas than when the escrow rule was proposed in 2013, but H.R. 1529 would still increase the number of exempt lenders. See CFPB, "Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)," at http://files.consumerfinance.gov/f/201509_cfpb_amendments-relating-to-small-creditors-and-rural-or-underserved-areas-under-the-truth-in-lending-act-regulation-z.pdf.

Supporters of H.R. 1529 and H.R. 5983 argue that expanding the escrow exemption is important for reducing the regulatory burden on small banks. Small banks already would have the incentive, the argument goes, to make sure the borrower will pay taxes and insurance even without the escrow account because the lender is exposed to some of the risk by keeping the mortgage in its portfolio.²¹⁶ Because of this "skin in the game," supporters argue the escrow requirement is unduly burdensome for small banks. They also believe the requirement can be an unnecessary burden to consumers who would rather manage their taxes and insurance payments on their own, especially if those consumers have a history of making their required payments on previous loans.²¹⁷

Opponents of H.R. 1529 and H.R. 5983 argue that the escrow requirement is an important consumer protection. The escrow account is required for higher-priced mortgage loans, and critics contend that the higher interest rate on those loans reflects the fact that borrowers with these loans often are riskier subprime borrowers.²¹⁸ Because these borrowers already face a higher risk of default, opponents of H.R. 1529 argue the escrow requirement is important for ensuring these borrowers are not, in the words of Ranking Member Maxine Waters, "being blindsided by additional costs at the end of each year."²¹⁹ They argue that the exemption the CFPB gave for certain smaller entities already strikes the appropriate balance between reducing the regulatory burden for some banks and protecting consumers.

Mortgage Servicers. The second part of H.R. 1529 and H.R. 5983 addresses *mortgage servicers*. Servicers received added attention from Congress after the surge in foreclosures following the bursting of the housing bubble. The Dodd-Frank Act imposed additional requirements on servicers to protect borrowers through amendments to TILA and RESPA.²²⁰ The new servicing protections²²¹ include, among other things, additional disclosure requirements about the timing of rate changes, requirements for how payments would be credited, obligations to address errors in a timely fashion, and guidance on when foreclosure could be initiated and how servicers must have continuity of contact with borrowers. The CFPB issued rules implementing those changes.²²²

Servicers that service 5,000 mortgages or fewer and only service mortgages that they or an affiliate owns or originated are considered *small servicers* and are exempted from some but not all TILA and RESPA servicing requirements.²²³ H.R. 1529 and H.R. 5983 would modify the exemption for the rules implemented under RESPA by directing the CFPB to provide exemptions to or adjustments from the RESPA servicing provisions for servicers that service 20,000 mortgages or fewer "in order to reduce regulatory burdens while appropriately balancing

²¹⁶ CQ Congressional Transcripts, "House Financial Services Committee Holds Markup on Financial Regulatory Legislation, March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?9&search=M9QutUd4>.

²¹⁷ *Ibid.*

²¹⁸ *Ibid.*

²¹⁹ *Ibid.*

²²⁰ 12 U.S.C. §§2601 et seq.

²²¹ Some of the servicing requirements are specific mandates in the Dodd-Frank Act, and some are issued at the discretion of the CFPB pursuant to its authority under RESPA and TILA.

²²² CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)," 78 *Federal Register* 10695, February 14, 2013, and CFPB, "Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 10901, February 14, 2013.

²²³ See, for example, 12 C.F.R. 1026.41. The CFPB provided exemptions to small servicers from certain TILA requirements using its authority under TILA. The CFPB elected not to extend certain RESPA requirements to small servicers. See CFPB, "Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X)," 78 *Federal Register* 10699, February 14, 2013.

consumer protections.”²²⁴ The RESPA servicing provisions that could be affected by H.R. 1529 include, among other things, how escrow accounts (if they are required) would be administered, disclosure to an applicant about whether his or her servicing can be sold or transferred, notice to the borrower if the loan is transferred, prohibitions on the servicer relating to fees and imposing certain types of insurance, and other consumer protections.²²⁵

Policy Discussion. In its discussion of its servicing rule, the CFPB notes that “servicers that service relatively few loans, all of which they either originated or hold on portfolio, generally have incentives to service well.”²²⁶ The incentive to service the loans well comes from the fact that “foregoing the returns to scale of a large servicing portfolio indicates that the servicer chooses not to profit from volume, and owning or having originated all of the loans serviced indicates a stake in either the performance of the loan or in an ongoing relationship with the borrower.”²²⁷ The CFPB, therefore, found that an “exemption may be appropriate only for servicers that service a relatively small number of loans and either own or originated the loans they service.”²²⁸

The CFPB set the loan threshold at 5,000 loans because it concluded that this category “identifies the group of servicers that make loans only or largely in their local communities or more generally have incentives to provide high levels of customer contact and information.”²²⁹ The CFPB’s data analysis of the threshold concluded that

With the threshold set at 5,000 loans, the Bureau estimates that over 98% of insured depositories and credit unions with under \$2 billion in assets fall beneath the threshold. In contrast, only 29% of such institutions with over \$2 billion in assets fall beneath the threshold and only 11% of such institutions with over \$10 billion in assets do so. Further, over 99.5% of insured depositories and credit unions that meet the traditional threshold for a community bank—\$1 billion in assets—fall beneath the threshold. The Bureau estimates there are about 60 million closed-end mortgage loans overall, with about 5.7 million serviced by insured depositories and credit unions that qualify for the exemption.²³⁰

The CFPB’s 2013 rulemaking did not discuss the effect of setting the threshold at 20,000 loans, as H.R. 1529 would, but it noted that if “the loan count threshold were set at 10,000 mortgage loans, for example, over 99.5% of insured depositories and credit unions with under \$2 billion in assets would fall beneath the threshold. However, 50% of insured depositories with over \$2 billion in assets and 20% of those with over \$10 billion in assets would fall beneath the threshold.”²³¹ Those entities that service more than 5,000 loans, the CFPB contends, may be more likely to use a different servicing model that would not have the same “incentives to provide high levels of customer contact and information.”²³² The CFPB, therefore, set the threshold at 5,000 loans.

²²⁴ H.R. 4521, §3.

²²⁵ For a full list, see 12 U.S.C. §2605 and CFPB, “Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X),” 78 *Federal Register* 10699, February 14, 2013.

²²⁶ CFPB, “Mortgage Servicing Rules Under the Truth in Lending Act (Regulation Z),” 78 *Federal Register* 10980, February 14, 2013.

²²⁷ *Ibid.*, p. 10980.

²²⁸ *Ibid.*, p. 10975.

²²⁹ *Ibid.*, p. 10981.

²³⁰ *Ibid.*, p. 10982.

²³¹ *Ibid.*, p. 10981.

²³² *Ibid.*, p. 10981. The CFPB notes that its estimates are only for depository institutions and do not include non-depositories due to data limitations.

Supporters of H.R. 1529 and H.R. 5983 argue that the proposals would give the CFPB the discretion to either provide “exemptions or adjustments to the requirements of the existing codes section and should do so appropriately balancing consumer protections. So the near-small institutions will either get the relief currently granted to the small institutions or a bit less relief, and that will be determined by the CFPB.”²³³ Raising the threshold from 5,000 loans to 20,000 loans, supporters argue, “will better delineate small servicers from the large servicers, and give credit union and community banks greater flexibility to ensure that more of their customers can stay in their homes.”²³⁴

Opponents of H.R. 1529 and H.R. 5983 have contended that the exemptions in the CFPB’s regulations are sufficient to protect small lenders and that expanding the exemptions would weaken the protections available to consumers. They note that by not only raising the threshold but also removing the requirement that servicers own the mortgage, the servicers would have “less skin in that game if bad servicing practices were to result in default and foreclosure.”²³⁵ Critics point to mortgage servicers in particular as actors that performed poorly during the foreclosure crisis and should not receive additional exemptions from CFPB regulations.²³⁶

CBO estimates that H.R. 1529 as ordered reported would “increase direct spending by less than \$500,000 for expenses of the CFPB to prepare and enforce new rules” but would not affect revenues or discretionary spending.²³⁷

Portfolio Qualified Mortgage (H.R. 1210, H.R. 5983, and S. 1484/S. 1910)²³⁸

The Portfolio Lending and Mortgage Access Act (H.R. 1210) was passed by the House on November 18, 2015. H.R. 1210 would establish a new qualified mortgage category for a mortgage held in a lender’s portfolio. Section 1116 of H.R. 5983 has nearly identical language to H.R. 1210. Section 106 of S. 1484 (Section 907 of S. 1910) would also establish a portfolio QM category but utilizes a different approach. S. 1484/S. 1910 would require a loan to meet stricter criteria than under H.R. 1210 and H.R. 5983 but would have more relaxed portfolio requirements than H.R. 1210 and H.R. 5983. The legislative proposals are intended to increase credit availability and to reduce the regulatory burden on lenders. Critics argue that the proposals would go too far in reducing consumer protections and would allow lenders to receive legal protections for offering risky, non-standard mortgage products.

²³³ Attributed to Rep. Brad Sherman by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation,” March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?0&search=4xqeO9ST>.

²³⁴ Attributed to Rep. Blaine Luetkemeyer by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation,” March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?0&search=4xqeO9ST>.

²³⁵ Attributed to Rep. Maxine Waters by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Regulatory Legislation,” March 25, 2015, at <http://www.cq.com/doc/financialtranscripts-4653577?0&search=4xqeO9ST>.

²³⁶ Ibid. See also CRS Report R41491, “Robo-Signing” and Other Alleged Documentation Problems in Judicial and Nonjudicial Foreclosure Processes, by (name redacted) .

²³⁷ CBO, *Cost Estimate: H.R. 1529 Community Institution Mortgage Relief Act of 2015, as ordered reported by the House Committee on Financial Services on March 26, 2015*, April 3, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr1529.pdf>.

²³⁸ This section was authored by Sean Hoskins, analyst in Financial Economics.

The Ability-to-Repay Rule and Portfolio Loans. Title XIV of the Dodd-Frank Act established the ability-to-repay (ATR) requirement. Under the ATR requirement, a lender must determine based on documented and verified information that, at the time a mortgage loan is made, the borrower has the ability to repay the loan. The rule enumerates the type of information that a lender must consider and verify prior to originating a loan, including the applicant's income or assets, credit history, outstanding debts, and other criteria. Lenders that fail to comply with the ATR rule could be subject to legal liability, such as the payment of certain statutory damages.²³⁹

A lender can comply with the ATR rule in one of two ways. A lender can either originate a mortgage that meets the less concrete underwriting and product feature standards of the General ATR Option or a mortgage that satisfies the more stringent, specific standards of the Qualified Mortgage. A QM is a mortgage that satisfies certain underwriting and product feature requirements. There are several different types of QM, with the different categories applying to different lenders and having different underwriting and product feature requirements. For example, the Standard QM that is available to all lenders requires the mortgage to not have balloon payments or a loan term over 30 years, has restrictions on the fees that can be charged, and has other requirements that must be met in order for the mortgage to receive QM status. These underwriting and product feature requirements are intended to ensure that a mortgage receiving QM status satisfies certain minimum standards, with the standards intended to offer protections to borrowers. A loan that satisfies the less concrete standards of the General ATR Option, in contrast, is allowed to have a balloon payment and a term in excess of 30 years so long as the lender verifies that the borrower would have the ability to repay the loan.

If a lender originates a mortgage that receives QM status, then it is presumed to have complied with the ATR rule and receives legal protections that could reduce its potential legal liability.²⁴⁰ As mentioned above, a lender can comply with the ATR rule by making a mortgage that is not a QM and instead satisfies the General ATR Option, but the lender will not receive the additional legal protections. The definition of a QM, therefore, is important to a lender seeking to minimize its *legal risk*. Because of this legal risk, some are concerned that, at least in the short term, few mortgages will be originated that do not meet the QM standards due to the legal protections that QMs afford lenders, even though there are other means of complying with the ATR rule.²⁴¹

If a mortgage does not receive QM status under the Standard QM—the general approach that most focus on when discussing the QM compliance options—the mortgage may still receive QM

²³⁹ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6416, January 30, 2013, at <https://www.gpo.gov/fdsys/pkg/FR-2013-01-30/pdf/2013-00736.pdf>.

²⁴⁰ A lender that originates a QM is entitled to a "presumption of compliance" with the ATR requirement, but the type of presumption of compliance and the amount of legal protection the lender receives depends on the mortgage interest rate. A QM with an annual percentage rate (APR) less than 1.5 percentage points above the average prime offer rate (APOR) for a first lien or less than 3.5 percentage points above the APOR for a subordinate lien qualifies for a *safe harbor*, a conclusive presumption of compliance with the ATR requirement. Mortgages that qualify for a safe harbor are referred to by the CFPB as *prime* mortgages. Mortgages above the thresholds that otherwise meet the QM requirements are deemed to be "higher-priced covered transactions" and qualify for a *rebuttable presumption* of compliance. The CFPB refers to QMs receiving a rebuttable presumption as *subprime* loans. See CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," 78 *Federal Register* 6408, January 30, 2013.

²⁴¹ CFPB, Prepared remarks of Richard Cordray at a meeting of the Credit Union National Association, February 27, 2013, at <http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-credit-union-national-association/>. For a preliminary analysis of the effect of the QM rule on originations, see Bing Bai, Data show surprisingly little impact of new mortgage rules, Urban Institute, August 21, 2014, at <http://www.urban.org/urban-wire/data-show-surprisingly-little-impact-new-mortgage-rules>.

status if it complies with the Small Creditor Portfolio QM option. To do so, three broad sets of criteria must be satisfied. First, the loan must be held in portfolio for at least three years (subject to several exceptions).²⁴² Second, the loan must be held by a small lender, which is defined as a lender who originated 2,000 or fewer mortgages in the previous year and has less than \$2 billion in assets.²⁴³ Third, the loan must meet certain underwriting and product feature requirements.²⁴⁴

Compared to the Standard QM, the Small Creditor Portfolio QM has less prescriptive underwriting requirements. For example, to receive QM status under the Standard QM, a borrower must have a debt-to-income (DTI) ratio below 43% after accounting for the payments associated with the mortgage and other debt obligations, but under the Small Creditor Portfolio QM, the lender is required to consider and verify the borrower's DTI but does not have a specific threshold that the borrower must be below.

The CFPB was willing to relax the underwriting standards for some portfolio loans because it believed "that portfolio loans made by small creditors are particularly likely to be made responsibly and to be affordable for the consumer."²⁴⁵ By keeping the loan in portfolio, the CFPB argues, small creditors have added incentive to consider whether the borrower will be able to repay the loan because the lender retains the default risk and could be exposed to losses if the borrower does not repay. This exposure, the argument goes, would encourage small creditors to provide additional scrutiny during the underwriting process, even in the absence of a legal requirement to do so. Keeping the mortgage in portfolio is intended to align "consumers' and creditors' interests regarding ability to repay."²⁴⁶

Policy Discussion. The Small Creditor Portfolio QM is intended to increase the amount of credit that is available to consumers by making it easier for small lenders to extend portfolio loans. Some in Congress argue that the Small Creditor Portfolio QM, while useful to expand credit and reduce regulatory burden, is too narrow. They propose establishing an additional portfolio QM option that would have more relaxed eligibility criteria. The proposals would allow larger lenders to participate and would not require all of the Small Creditor Portfolio QM's underwriting and product feature requirements (such as the DTI ratio) to be met in order to receive QM status.

Supporters of an expanded portfolio lending option argue that when a larger lender holds the mortgage in portfolio, it too has the incentive to ensure that the borrower will repay the loan because it is also exposed to the risk of default. They argue that this incentive is present whether the lender is large or small. The incentive to ensure the loan is properly underwritten, supporters argue, is sufficient to merit the loan receiving QM status and the commensurate legal protections. Extending the legal protections to portfolio loans, the argument goes, will encourage lenders to expand credit and allow more individuals to purchase homes.

²⁴² CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act," p. 5, at http://files.consumerfinance.gov/f/201305_cfpb_final-rule_atr-concurrent-final-rule.pdf.

²⁴³ The definition of "small" can be found in 12 C.F.R. §1026.35(b)(2)(iii)(B) and (C). The CFPB changed its definition of small from originating 500 mortgages in the previous calendar year to 2,000 mortgages. See CFPB, "Amendments Relating to Small Creditors and Rural or Underserved Areas Under the Truth in Lending Act (Regulation Z)," at http://files.consumerfinance.gov/f/201509_cfpb_amendments-relating-to-small-creditors-and-rural-or-underserved-areas-under-the-truth-in-lending-act-regulation-z.pdf.

²⁴⁴ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 35431, June 12, 2013.

²⁴⁵ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 6539, January 30, 2013.

²⁴⁶ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 35483, June 12, 2013.

Critics of the proposals contend that the incentive alignment associated with holding a mortgage in portfolio is not sufficient to justify extending QM status to portfolio loans held by large lenders. Certain traits that are more likely to be found in small lenders, they argue, are also important for ensuring that a lender thoroughly evaluates a borrower's ability to repay. The CFPB limited the Small Creditor Portfolio QM to small lenders because the CFPB believes the "relationship-based" business model often employed by small lenders may make small lenders better able to assess a borrower's ability to repay than larger lenders.²⁴⁷ Additionally, the CFPB argues that small lenders often have close ties to their communities, which provides added incentive to thoroughly underwrite their mortgages for the borrower's ability to repay.²⁴⁸ The level at which a lender should not be considered small because it no longer is influenced by its ties to its communities, however, is subject to much debate.

CBO estimates that H.R. 1210 as ordered reported could affect direct spending but that the effect would be insignificant. The bill would not affect revenues. CBO notes that the more relaxed definition of QM could result in higher losses to financial institutions which could increase their likelihood of failure and potential cost to the government, but CBO states that this is a small probability that "CBO's baseline estimates would result in additional costs to the federal government of less than \$500,000 over the 2016-2025 period."²⁴⁹

Integrated Disclosure Forms (H.R. 3192 and S. 1484/S. 1910)²⁵⁰

The Homebuyers Assistance Act (H.R. 3192) was passed by the House on October 7, 2015. H.R. 3192 as passed would have prevented the TILA and RESPA integrated disclosure requirements from being enforced until February 1, 2016. It would also have prohibited anyone from filing a suit against a lender related to the TILA-RESPA integrated disclosure forms during that time period so long as the lender has made a good faith effort to comply with the requirements.

Section 117 of S. 1484 (Section 918 of S. 1910) would provide a safe harbor for lenders related to the integrated disclosure forms. It would make a lender that provides the required disclosures not "subject to any civil, criminal, or administrative action or penalty for failure to fully comply."²⁵¹ The safe harbor would be in effect until one month after the CFPB director certifies that the new disclosures "are accurate and in compliance with all State laws."²⁵² In addition, S. 1484/S. 1910 would eliminate the requirement that a mortgage closing be delayed three days if the lender offered the borrower a mortgage with a lower annual percentage rate than the rate that was originally offered.

Integrated Disclosures. On November 20, 2013, the CFPB issued the TILA-RESPA Final Rule that would require mortgage lenders to use more easily understood and streamlined mortgage disclosure forms.²⁵³ TILA and RESPA have long required lenders to provide consumers

²⁴⁷ CFPB, "Ability-to-Repay and Qualified Mortgage Standards Under the Truth in Lending Act (Regulation Z)," 78 *Federal Register* 35437, June 12, 2013.

²⁴⁸ *Ibid.*

²⁴⁹ CBO, *Cost Estimate: H.R. 1210 Portfolio Lending and Mortgage Access Act, as ordered reported by the House Committee on Financial Services on July 29, 2015*, September 29, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr1210.pdf>.

²⁵⁰ Parts of this section were adapted from CRS Legal Sidebar WSLG1348, *Administrative Gaffe Forces CFPB to Delay Mortgage Disclosure Rule*, by (name redacted).

²⁵¹ S. 1484, §117 (S. 1910, §918).

²⁵² S. 1484, §117 (S. 1910, §918).

²⁵³ CFPB, "Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the (continued...)"

disclosures about the estimated and actual real estate settlement costs and financial terms of the mortgages they offer. These disclosures are intended to help consumers compare the terms and make informed decisions regarding the suitability of various mortgage products and services they are offered. However, TILA and RESPA required disclosures of duplicative information while using inconsistent language, which might have led to increased regulatory costs and consumer confusion.²⁵⁴ In light of these concerns, Sections 1098 and 1100A of the Dodd-Frank Act required the CFPB to develop "a single, integrated disclosure for mortgage loan transactions ... to aid the borrower ... in understanding the transaction by utilizing readily understandable language to simplify the technical nature of the disclosures" that remains compliant with both TILA and RESPA.²⁵⁵

The TILA-RESPA Final Rule is the culmination of more than two years of study through, among other things, consumer testing and a Small Business Review Panel.²⁵⁶ The Board of Governors of the Federal Reserve System and the Department of Housing and Urban Development, which prior to the Dodd-Frank Act implemented TILA and RESPA, had attempted but failed to make similar changes to these disclosure forms. In short, combining these mortgage disclosures into a single form was a massive undertaking, and, upon taking effect, the TILA-RESPA Final Rule will have a significant impact on consumers, lenders, and other participants in the mortgage market.

Policy Discussion. The CFPB chose to give the industry until August 1, 2015—nearly two years from the date on which the Final Rule was first publicly released—to comply. In spite of this lead time, mortgage bankers and lenders have expressed concern about their inability to update software and make other necessary changes to meet the compliance deadline.²⁵⁷ This led some to ask CFPB Director Richard Cordray for additional time to comply before the CFPB starts enforcing the law.²⁵⁸ Those requests went unheeded until it was discovered that, because of an "administrative error,"²⁵⁹ the August 1st effective date would violate a provision of the Congressional Review Act²⁶⁰ that prevents a *major rule*²⁶¹ from going into effect until at least 60 days from the date on which the rule was published in the *Federal Register* or was formally reported to Congress, whichever is later. The CFPB announced that, "[t]o comply with the CRA and to help ensure the smooth implementation of the TILA-RESPA Final Rule, the Bureau is extending the effective date ... [from August 1 to] October 3, 2015...."²⁶²

(...continued)

Truth In Lending Act (Regulation Z)," 78 *Federal Register* 79730, December 31, 2013.

²⁵⁴ CFPB, "Integrated Mortgage Disclosures Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth In Lending Act (Regulation Z)," 78 *Federal Register* 79734, December 31, 2013.

²⁵⁵ P.L. 111-203, §1100A.

²⁵⁶ CFPB, "Know Before You Owe," at <http://www.consumerfinance.gov/know-before-you-owe/>.

²⁵⁷ Lisa Prevost, "Request for Delay of Mortgage-Disclosure Rule," *The New York Times*, May 29, 2015, at <http://www.nytimes.com/2015/05/31/realestate/request-for-delay-of-mortgage-disclosure-rule.html>.

²⁵⁸ Letter from industry groups to Richard Cordray, Director of the CFPB, March 18, 2015, at <https://www.mba.org/Documents/Comment%20Letters/03-18-15sign-onlettertoCFPBonTILA-RESPA.PDF>.

²⁵⁹ CFPB, "2013 Integrated Mortgage Disclosures Under RESPA and TILA; Delay of Effective Date," at http://files.consumerfinance.gov/f/201507_cfpb_2013-integrated-mortgage-disclosures-rule-under-the-real-estate-settlement-procedures-act-regulation-x-and-the-truth-in-lending-act-regulation-z-and-amendments-delay-of-effective-date.pdf.

²⁶⁰ 5 U.S.C. §801 et seq.

²⁶¹ For the definition of *major rule*, see 5 U.S.C. §804.

²⁶² CFPB, "2013 Integrated Mortgage Disclosures Under RESPA and TILA; Delay of Effective Date," at http://files.consumerfinance.gov/f/201507_cfpb_2013-integrated-mortgage-disclosures-rule-under-the-real-estate-settlement-procedures-act-regulation-x-and-the-truth-in-lending-act-regulation-z-and-amendments-delay-of-effective-date.pdf (continued...)

The CFPB has also announced what some have characterized as a restrained enforcement period related to the integrated disclosures.²⁶³ In a letter to Members of Congress, the CFPB stated that its “oversight of the implementation of the Rule will be sensitive to the progress made by those entities that have squarely focused on making good-faith efforts to come into compliance with the Rule on time.”²⁶⁴ The CFPB also announced that it sent a letter to industry trade groups in which it stated that

During initial examinations for compliance with the rule, the Bureau’s examiners will evaluate an institution’s compliance management system and overall efforts to come into compliance, recognizing the scope and scale of changes necessary for each supervised institution to achieve effective compliance. Examiners will expect supervised entities to make good faith efforts to comply with the rule’s requirements in a timely manner. Specifically, examiners will consider: the institution’s implementation plan, including actions taken to update policies, procedures, and processes; its training of appropriate staff; and, its handling of early technical problems or other implementation challenges.²⁶⁵

Supporters of H.R. 3192 and S. 1484/S. 1910 argued that an additional two months is insufficient for lenders to make the upgrades needed to satisfy the deadline and that the restrained enforcement period does not address several underlying concerns. Supporters of a safe harbor contend that lenders should have to use the new disclosure forms and procedures but should have a grace period to test out the new systems.²⁶⁶ The grace period that supporters sought would not just apply to actions taken by the regulators but would also protect lenders from being sued by borrowers claiming that the correct disclosure forms and procedures were not followed. The threat of this private litigation risk, supporters argue, is not addressed by the CFPB’s extension and could cause some lenders to delay or cancel mortgage closings if there is uncertainty about how the new process should be implemented.²⁶⁷ In addition, supporters of a delay argue that there is uncertainty as to whether the rule conflicts with state law, and the potential conflicts should be clarified prior to implementation.²⁶⁸

Critics of delaying the implementation argued that the actions already taken by the CFPB are sufficient to protect lenders from the risks that they face and that the extended implementation timeframe allows lenders enough time to adopt the necessary systems and processes. They also argued “that private liability works to ensure that regulated entities are diligent in complying

(...continued)

date.pdf.

²⁶³ Trey Garrison, “Industry Welcomes TRID Grace Period But Congress Says It’s Not Enough,” *Housingwire*, June 3, 2015, at <http://www.housingwire.com/articles/34086-industry-welcomes-trid-grace-period-but-congress-says-its-not-enough>.

²⁶⁴ Letter from Richard Cordray, CFPB Director, to Rep. Barr and Maloney, June 3, 2015, at http://www.cfpbmonitor.com/files/2015/06/2015-06-03-RC-to-Barr-Maloney-et-al_TILA-RESPA.pdf. Also see, CFPB, “Know Before You Owe: You’ll get 3 days to review your mortgage closing documents,” June 3, 2015, at <http://www.consumerfinance.gov/blog/know-before-you-owe-youll-get-3-days-to-review-your-mortgage-closing-documents/>.

²⁶⁵ CFPB, “CFPB Sends Industry Letter on Know Before You Owe Mortgage Disclosure Rule Compliance,” press release, October 2, 2015, at <http://www.consumerfinance.gov/about-us/newsroom/cfpb-sends-industry-letter-on-know-before-you-owe-mortgage-disclosure-rule-compliance/>.

²⁶⁶ Rep. Andy Barr, “Barr Responds to CFPB’s New TRID Effective Date,” press release, June 18, 2015, at <https://barr.house.gov/media-center/press-releases/barr-responds-to-cfpb-s-new-trid-effective-date>.

²⁶⁷ *Ibid.*

²⁶⁸ Mortgage Bankers Association, “TILA-RESPA Integrated Disclosure Rule,” at <https://www.mba.org/issues/residential-issues/tila/RESPA-integration-rule>.

promptly with the new TRID disclosures” and that the private liability should not be delayed.²⁶⁹ Critics also note that the litigation risk “that [is] part of the new TRID rule has been overstated, as private litigants rarely bring actions that prevail under the provisions of TILA that are implicated by the new TRID disclosures.”²⁷⁰ The delay that some were hoping for, according to critics, “is unnecessary in light of the limited liability for disclosure-related violations under TILA and the steps already taken by the CFPB.”²⁷¹ If a further delay were put in place, some argue that homeowners “who would receive false or misleading mortgage cost disclosures during such a period would have no remedy.”²⁷²

CBO estimated that H.R. 3192 as ordered reported would have resulted in a negligible increase in direct spending and would not have affected revenues or discretionary spending.²⁷³

Privacy Notifications (H.R. 22, H.R. 601, and S. 1484/S. 1910)²⁷⁴

The Eliminate Privacy Notice Confusion Act (H.R. 601) was passed by the House on April 13, 2015. It was then included in the Fixing America’s Surface Transportation Act (H.R. 22/P.L. 114-94). Section 101 of S. 1484 (Section 902 of S. 1910) includes similar language. These proposals would reduce the number of scenarios under which financial firms were required to send customers privacy notices. Under H.R. 601, financial firms would no longer be required to send annual privacy notices if their privacy policy had not changed. Under S. 1484/S. 1910, financial firms would no longer be required to send annual privacy notices if their privacy policy had not changed and if the firm made the most recent privacy notice available to customers electronically. Cases in which third-party information sharing triggers notification and the opportunity to opt out under current law would remain unchanged.²⁷⁵ It is an example of a regulatory relief bill amending a law that predates the financial crisis.

Background. Under a provision of the Gramm-Leach-Bliley Act (15 U.S.C. §6803), financial firms, including banks, are required to send customers privacy notices when they establish a relationship with the customer and annually thereafter. Firms also are required to send customers notices explaining how customers may opt out of allowing the firm to share their personal information with third parties, under certain circumstances.²⁷⁶

Policy Discussion. Financial firms argue that the privacy notice requirement is unduly burdensome to them and of little value to customers because the notices are lengthy, confusing,

²⁶⁹ Attributed to Rep. Maxine Waters by CQ Congressional Transcripts, “House Financial Services Committee Holds Markup on Financial Services Bills, Day 1,” July 28, 2015, at <http://www.cq.com/doc/financialtranscripts-4736108?0>.

²⁷⁰ Ibid.

²⁷¹ Ibid.

²⁷² Letter from Consumer Groups to Members of Congress, July 27, 2015, at <https://www.nclc.org/images/pdf/legislation/letter-opposing-hr3192-2015.pdf>.

²⁷³ CBO, *Cost Estimate: H.R. 3192 Homebuyers Assistance Act, as ordered reported by the House Committee on Financial Services on July 29, 2015*, September 28, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr3192.pdf>.

²⁷⁴ This section was authored by (name redacted), specialist in Macroeconomic Policy.

²⁷⁵ U.S. Congress, House Committee on Financial Services, *Eliminate Privacy Notice Confusion Act*, report to accompany H.R. 601, 114th Cong., 1st sess., April 13, 2015, H.Rept. 114-59.

²⁷⁶ For a summary of the requirement, see Federal Trade Commission, *In Brief: The Financial Privacy Requirements of the Gramm-Leach-Bliley Act*, July 2002, at <https://www.ftc.gov/tips-advice/business-center/guidance/brief-financial-privacy-requirements-gramm-leach-bliley-act>.

and thus likely to be ignored. Defenders of current law argue that it provides consumer protection and safeguards privacy.²⁷⁷

The CFPB contends that a rule it issued in 2014 modifying Regulation P (which implements 15 U.S.C. §6803) will reduce the regulatory burden of compliance without undermining the policy's benefits.²⁷⁸ The 2014 CFPB rule allows firms under certain conditions to post privacy notices on the Internet rather than mail hard copies to customers. The rule requires firms to continue sending printed notices when privacy policies are changed or information is shared with third parties. Firms are required to provide annual notification that privacy notices are available on the Internet and to provide printed notices upon request. Some believe additional relief is needed beyond what was provided in the 2014 CFPB rule.

CBO estimates that H.R. 601 as ordered reported would result in an increase in direct spending that would not be significant.²⁷⁹ The bill would not affect revenues or discretionary spending.

Durbin Amendment (H.R. 5983)²⁸⁰

Section 335 of the FCA would repeal Section 1075 of the Dodd-Frank Act, commonly referred to as the "Durbin Amendment," which caps interchange fees for debit card transactions involving institutions with more than \$10 billion in assets.

Background. When a consumer uses a debit card in a transaction, the merchant pays a "swipe" fee, which is also known as the interchange fee. The interchange fee is paid to the card-issuing bank (the consumer's bank that issued the debit card), and the fee compensates the bank for facilitating the transaction.

Under the Durbin Amendment, the Federal Reserve prescribed regulations to ensure that the amount of any interchange transaction fee received by a debit card issuer is reasonable and proportional to the cost incurred by the issuer. The Federal Reserve may consider the authorization, clearance, and settlement costs of each transaction when it sets the interchange fee. The Durbin Amendment allows the interchange fee to be adjusted for costs incurred by debit card issuers to prevent fraud. Debit card issuers with less than \$10 billion in assets are exempt by statute from the regulation, which means that smaller financial institutions may receive a larger interchange fee than larger issuers. The Durbin Amendment also prohibits network providers (e.g., Visa and MasterCard) and debit card issuers from imposing restrictions that would override a merchant's choice of the network provider through which to route transactions.

On June 29, 2011, the Federal Reserve issued a final rule implementing the Durbin Amendment by Regulation II, which includes a cap of 21 cents plus 0.05% of the value of the transaction (and an additional 1 cent to account for fraud protection costs) on the interchange fee for large issuers.²⁸¹ The rule went into effect on October 1, 2011.

²⁷⁷ CFPB, 12 C.F.R. Part 1016, Docket No. CFPB–2014–0010, RIN 3170–AA39, p. 64059, at <http://www.gpo.gov/fdsys/pkg/FR-2014-10-28/pdf/2014-25299.pdf>; <http://fsroundtable.org/hr-601-eliminate-privacy-notice-confusion-act/>.

²⁷⁸ CFPB, 12 C.F.R. Part 1016, Docket No. CFPB–2014–0010, RIN 3170–AA39, at <http://www.gpo.gov/fdsys/pkg/FR-2014-10-28/pdf/2014-25299.pdf>.

²⁷⁹ CBO, *Cost Estimate: H.R. 601 Eliminate Privacy Notice Confusion Act, as ordered reported by the House Committee on Financial Services on March 26, 2015*, April 7, 2015, at <https://www.cbo.gov/sites/default/files/cbofiles/attachments/hr601.pdf>.

²⁸⁰ This section was authored by Darryl Getter, specialist in Financial Economics. For more analysis of the Durbin Amendment, see CRS Report R41913, *Regulation of Debit Interchange Fees*, by (name redacted).

²⁸¹ Federal Reserve, "Debit Card Interchange Fees and Routing," 76 *Federal Register* 43394, July 20, 2011.

Policy Discussion. The supporters of the Durbin Amendment argued that the network providers were using their market power to keep interchange fees elevated above the price that would prevail in perfectly competitive markets to the detriment of businesses and consumers.²⁸² Capping the fees for the largest issuers, they argued, would result in cost savings for businesses and consumers while still allowing small banks to compete with larger banks. Critics of the Durbin Amendment and those who advocate for its repeal argue that it is a system of government price fixing that does not allow for private sector entities to negotiate a competitive price and reduces industry's incentives to improve quality and innovate.²⁸³ In addition, critics argue that in restricting banks' revenues, banks have an incentive to pass additional costs on to consumers or find other ways of reducing costs.

Supervision and Enforcement

Supervision refers to the power to examine banks, instruct banks to modify their behavior, and to impose reporting requirements on banks to ensure compliance with rules. In some cases, examiners confirm whether banks meet quantitative targets and thresholds set by regulation; in others, they have discretion to interpret whether a bank's actions satisfy the goals of a regulation. *Enforcement* is the authority to take certain legal actions, such as imposing fines, against an institution that fails to comply with rules and laws.

While regulators generally view their supervisory and enforcement actions as striking the appropriate balance between ensuring that institutions are well managed and minimizing the burden facing banks, others believe the regulators are overreaching and preventing banks from serving their customers.

Bank Exams

On-site examinations, which stem from a regulator's visitorial powers, are part of the supervisory process. A regulator's visitorial powers include

- (i) Examination of a bank; (ii) Inspection of a bank's books and records; (iii) Regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (iv) Enforcing compliance with any applicable Federal or state laws concerning those activities, including through investigations that seek to ascertain compliance through production of non-public information by the bank ... [with certain limitations].²⁸⁴

Exam Frequency for Small Banks (H.R. 22, H.R. 1553 and S. 1484/S. 1910)²⁸⁵

Section 109 of S. 1484 (Section 910 of S. 1910) would raise the size thresholds for banks subject to an 18-month exam cycle from \$500 million to \$1 billion in assets if the bank received an outstanding exam rating. For banks that received a good exam rating, it gives the regulator

²⁸² Senator Dick Durbin, "Durbin Sends Letter To Wall Street Reform Conferees On Interchange Amendment," press release, May 25, 2010, at <http://www.durbin.senate.gov/newsroom/press-releases/durbin-sends-letter-to-wall-street-reform-conferees-on-interchange-amendment>.

²⁸³ House Committee on Financial Services, *The Financial CHOICE Act: A Republican Proposal to Reform the Financial Regulatory System*, June 23, 2016, p. 87, at http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

²⁸⁴ 12 C.F.R. §7.4000.

²⁸⁵ This section was authored by Sean Hoskins, analyst in Financial Economics, and (name redacted), specialist in Macroeconomic Policy.

discretion to raise the threshold from \$100 million up to \$1 billion (currently, the regulator may raise it to up to \$500 million) in assets if it believes raising it would be consistent with safety and soundness.

H.R. 1553 was passed by the House on October 6, 2015. It was then included in the Fixing America's Surface Transportation Act (H.R. 22/P.L. 114-94). The provision raised the size thresholds for banks subject to an 18-month exam cycle from \$500 million to \$1 billion in assets if the bank received an outstanding exam rating and from \$100 million to \$200 million if the bank received a good exam rating. It gives the bank regulator discretion to raise the latter threshold from \$200 million up to \$1 billion (currently, the regulator may raise it to up to \$500 million) in assets if it believes raising it would be consistent with safety and soundness. CBO estimates that the net budgetary effects of the bill would be insignificant.²⁸⁶

Background. Regulators examine banks at least once every 12 months, but banks with less than \$500 million in total assets that have high supervisory ratings and meet certain conditions are examined once every 18 months.²⁸⁷ Regulators changed the frequency of examinations in 2007 from once every 12 months to once every 18 months pursuant to the Financial Services Regulatory Relief Act.²⁸⁸ In contrast, some large and complex banks have examiners conducting full-time monitoring on-site. The bank receives a report of the findings when an examination is completed.

Policy Discussion. CBO estimates that 500 to 600 institutions would see the frequency of their exams reduced under H.R. 1553.²⁸⁹ Regulators have taken steps to reduce the regulatory burden associated with on-site examinations. The Fed introduced a new examination program in January 2014 that, according to Governor Tarullo, "more explicitly links examination intensity to the individual community bank's risk profile.... The new program calls for examiners to spend less time on low-risk compliance issues at community banks."²⁹⁰ In testimony before the Senate Banking Committee, Governor Tarullo also stated,

Recognizing the burden that the on-site presence of many examiners can place on the day-to-day business of a community bank, we are also working to increase our level of off-site supervisory activities.... To that end, last year we completed a pilot on conducting parts of the labor-intensive loan review off-site using electronic records from banks.²⁹¹

²⁸⁶ CBO, *Cost Estimate: H.R. 1553 Small Bank Exam Cycle Reform Act of 201, as ordered reported by the House Committee on Financial Services on July 29, 2015*, September 10, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr1553.pdf>.

²⁸⁷ For example, see Federal Reserve, "Inspection Frequency and Scope Requirements for Bank Holding Companies and Savings and Loan Holding Companies with Total Consolidated Assets of \$10 Billion or Less," SR 13-21, December 17, 2013, at <http://www.federalreserve.gov/bankinfo/srletters/sr1321.htm>.

²⁸⁸ P.L. 109-351. For more information, see FFIEC, *Joint Report to Congress: EGRPRA*, July 31, 2007, p. 60, at <http://egrpra.ffiec.gov/docs/egrpra-joint-report.pdf>.

²⁸⁹ CBO, *Cost Estimate for H.R. 1553*, September 10, 2015, <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr1553.pdf>.

²⁹⁰ Federal Reserve Gov. Daniel Tarullo, "A Tiered Approach to Regulation and Supervision of Community Banks," speech at the Community Bankers Symposium, Chicago, Illinois, November, 7, 2014, at <http://www.federalreserve.gov/newsevents/speech/tarullo20141107a.htm>.

²⁹¹ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Governor Daniel K. Tarullo, Federal Reserve*, 113th Cong., 2nd sess., September 9, 2014. More information on the pilot program is available at Federal Reserve, "Federal Reserve Seeks to Conduct More Loan Reviews Off-Site," at <https://www.communitybankingconnections.org/articles/2014/q2/loan-reviews-off-site>.

Although regulators have already taken these steps to reduce regulatory burden related to exams, the OCC has proposed increasing the threshold for the 18-month exam cycle to banks with \$750 million.²⁹²

In response to a congressional request, bank regulators' inspectors general conducted studies on the regulatory burden to small banks stemming from compliance with supervisory exams. From 2007 to 2011, OCC community bank exams typically took 120 days or less (as they are intended to), but sometimes took up to a year, and occasionally took over a year.²⁹³ The length of exams was slightly longer from 2008 to 2010, when the most banks were failing. In 2011, FDIC community bank risk-management exams varied in length from an average of 335 hours to 1,820 hours based on the size of the bank and its supervisory rating. From 2007 to 2011, exams of banks with poor supervisory ratings became shorter over time and banks with good supervisory ratings took longer over time. In addition, the FDIC conducts thousands of compliance and a few CRA exams annually. In 2011, the FDIC spent an average of 24 days to 57 days on-site for risk management exams, based on supervisory rating.²⁹⁴ Fed exams (not including state-led exams, which took longer), averaged 63 days to 79 days between 2007 and 2011, peaking in 2009.²⁹⁵ Although costs cannot be derived directly from hours spent on exams, these data may nevertheless give some indication of regulatory burden caused by meeting with examination staff and uncertainty created while waiting for exam results.

One concern raised by small banks is that there are economies of scale in compliance—in other words, compliance costs rise less than proportionately with size. The FDIC inspector general's study provides some evidence of economies of scale in compliance in the area of exams. It found that exams of banks with less than \$50 million in assets averaged 335 hours, whereas banks with \$500 million-\$1 billion in assets averaged 850 hours in 2011. In other words, exams for larger banks took longer, but the increase in hours was not linear with the increase in assets.²⁹⁶

Exam Ombudsman and Appeals Process (H.R. 1941, H.R. 5983, and S. 1484/S. 1910)²⁹⁷

H.R. 1941 was ordered to be reported by the House Financial Services Committee on July 29, 2015. It was also included in Section 1136 of H.R. 5983. It would require regulators to provide a bank a final exam report within 60 days of the conclusion of the exam exit interview or when follow-up materials have been provided. It would require the exit interview to take place no more than nine months after the exam begins unless the agency provides written notice for an

²⁹² Senior Deputy Comptroller Toney Bland, *Testimony before the House Financial Services Committee*, 114th Congress, April 23, 2015, at <http://financialservices.house.gov/uploadedfiles/hhrg-114-ba15-wstate-tbland-20150423.pdf>.

²⁹³ Department of the Treasury, Office of Inspector General, *Safety and Soundness: Review of OCC Community Bank Examination and Appeals Processes*, August 31, 2012, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG12070.pdf>.

²⁹⁴ See FDIC, Office of Inspector General, *The FDIC's Examination Process for Small Community Banks*, AUD-12-011, p. 8, August 2012, at <http://www.fdicog.gov/reports12/12-011AUD.pdf>.

²⁹⁵ Federal Reserve, Office of Inspector General, *Audit of the Small Community Bank Examination Process*, p. 18, August 2012, at http://oig.federalreserve.gov/reports/Audit_SCB_Exam_Process_August2012.pdf.

²⁹⁶ Data are for banks with high CAMELS rating. See FDIC Office of Inspector General, *The FDIC's Examination Process for Small Community Banks*, AUD-12-011, August 2012, at <http://www.fdicog.gov/reports12/12-011AUD.pdf>.

²⁹⁷ This section was authored by Sean Hoskins, analyst in Financial Economics, and (name redacted), specialist in Macroeconomic Policy.

extension. It sets detailed exam standards for commercial loans to prevent an adverse action when the underlying collateral has deteriorated. It would require the banking regulators to harmonize their standards for non-accrual loans. It would establish an ombudsman (called the Office of Independent Examination Review) within the Federal Financial Institutions Examination Council (FFIEC)²⁹⁸ to investigate complaints from banks about supervisory exams. The head of the office would be appointed by FFIEC. It would prohibit specific actions by the supervisor in retaliation for appealing. It would give banks the right to appeal exam results to the ombudsman or an administrative law judge, and would not allow the ombudsman or judge to defer to the supervisor's opinions. It would not permit further appeal by the supervisor, but would allow the bank to appeal this decision to appellate court. It would add the CFPB to the statutory appeals process,²⁹⁹ including the new ombudsman. CBO estimates that H.R. 1941 would increase budget deficits by \$232 million between 2016 and 2026.³⁰⁰

Section 104 of S. 1484 (Section 905 of S. 1910) similarly would establish an ombudsman (called the Office of Independent Examination Review) within FFIEC to investigate complaints from banks about supervisory exams. The head of the office would be appointed by FFIEC to a five-year term, but could be removed by the President without cause. It would prohibit specific actions by the supervisor in retaliation for appealing. It would add the CFPB to the statutory appeals process, including the new ombudsman.

Background. Bank regulators have established multiple processes for a bank to appeal the results of its examination.³⁰¹ Regulators typically encourage a bank to attempt to resolve any dispute informally through discussions with the bank examiner.³⁰² The Riegle Community Development and Regulatory Improvement Act of 1994³⁰³ required banking regulators to establish a formal independent appeals process for supervisory findings, appoint an independent ombudsman, and create safeguards to prevent retaliation (which is not defined in the act) against a bank that disputes their examination findings.³⁰⁴ While each ombudsman's exact role varies by agency, they generally fit the description of the Fed's—to "serve as a facilitator and mediator for the timely resolution of complaints."³⁰⁵ The independent appeals process currently involves bank examiners at the agency that were not involved in the examination, as well as agency leadership. Only the OCC allows banks to appeal an examination directly to the agency's ombudsman.³⁰⁶

²⁹⁸ The Federal Financial Institutions Examination Council (FFIEC) is an interagency council established by Congress to "prescribe uniform principles and standards for federal examination of financial institutions" and create standardized reporting forms. FFIEC consists of representatives from the OCC, Fed, FDIC, NCUA, CFPB, and a state regulator.

²⁹⁹ 12 U.S.C. §4806.

³⁰⁰ CBO, *Cost Estimate: H.R. 1941 Financial Institutions Examination Fairness and Reform Act, as ordered reported by the House Committee on Financial Services on July 29, 2015*, February 11, 2016, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr1941.pdf>.

³⁰¹ The CFPB only examines banks with over \$10 billion in assets.

³⁰² See OCC, *OCC Bulletin 2013-15: Bank Appeals Process*, at <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-15.html>.

³⁰³ P.L. 103-325.

³⁰⁴ P.L. 103-325, §309.

³⁰⁵ Federal Reserve, Office of Inspector General, *Audit of the Small Community Bank Examination Process*, August 2012, p. 23, at http://oig.federalreserve.gov/reports/Audit_SCB_Exam_Process_August2012.pdf.

³⁰⁶ OCC, "Guidance for Bankers," June 7, 2013, at <http://www.occ.gov/news-issuances/bulletins/2013/bulletin-2013-15.html>.

Policy Discussion. By statute,³⁰⁷ banks may already appeal exam results to the regulator that conducted it, and each banking agency already has an ombudsman. Skeptics view the creation of an additional ombudsman for all banking agencies as redundant. Proponents of the legislation argue that the proposed ombudsman would be more independent from the banking agencies, although it would be funded by the agencies³⁰⁸ and would still be located within a forum (FFIEC) controlled by the banking agencies. The role of ombudsman in the appeals process in H.R. 1491 would be new for all of the regulators except the OCC, however.

In exams, supervisors are balancing the profitability of the bank with the risk of bank failure to the taxpayer. Critics of H.R. 1491 argue that shifting the appeals process away from the regulator to the newly created ombudsman would put the taxpayer at risk by making it more likely that supervisory decisions would be overturned. Further, the new ombudsman would arguably not have "inside knowledge" of the supervisory process, which involves discretion. Proponents of H.R. 1491 argue that in the current appeals process, the supervisor plays the role of prosecutor, judge, and jury, and therefore the supervisor is unlikely to be willing to admit that a mistake had been made in the original exam. In the American Bankers Association's view, the current process is "time-consuming, expensive, and rarely result in a reversal of the matter being appealed. There also is a concern among ABA members that appealing will risk examiner retribution,"³⁰⁹ though retaliation is already forbidden by statute. The knowledge that exams could be independently appealed could make examiners more careful to adhere to guidelines, or it could make them less willing to make adverse decisions so as to avoid the "hassle" of appeals.

The urgency of changing the appeals process depends on how well it is currently working. Since all supervisory information is confidential, disputes about the fairness of exams and appeals are prone to a "he said/she said" dynamic between bank and regulator that is difficult for a third party to evaluate. The frequency of appeals might give some indication of bank displeasure with the examination process. In response to a congressional request, bank regulators' inspectors general conducted studies on the regulatory burden to small banks and found that banks only formally appealed 22 OCC exam results (informally appealed 24 more), 23 FDIC exams (informally appealed 18 more), and 12 Fed exams (no informal appeal data) out of the thousands of exams performed between 2007 and 2011.³¹⁰ However, banks might not appeal an exam result they thought was unfair if they thought their appeal had no chance of succeeding. Further, many disputes are resolved informally through the supervisory process, before an exam is completed.

Call Report Reform (H.R. 5983, S. 1484/S. 1910)³¹¹

The primary source of bank regulatory data is the quarterly Reports of Condition and Income, or *call report*, that a bank submits to its regulator. Section 119 of S. 1484 (Section 920 of S. 1910)

³⁰⁷ 12 U.S.C. §4806.

³⁰⁸ The ombudsman is explicitly funded by the regulators in S. 1494, but funding is not specified in H.R. 1941.

³⁰⁹ American Bankers Association, "Examination Review/Appeals Process," at http://www.aba.com/Issues/Index/Pages/Issues_ExaminationReview.aspx.

³¹⁰ Department of the Treasury, Office of Inspector General, *Safety and Soundness: Review of OCC Community Bank Examination and Appeals Processes*, August 31, 2012, at <http://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG12070.pdf>; FDIC, Office of Inspector General, *The FDIC's Examination Process for Small Community Banks*, AUD-12-011, August 2012, at <http://www.fdicog.gov/reports12/12-011AUD.pdf>; Federal Reserve, Office of Inspector General, *Audit of the Small Community Bank Examination Process*, August 2012, at http://oig.federalreserve.gov/reports/Audit_SCB_Exam_Process_August2012.pdf.

³¹¹ This section was authored by Sean Hoskins, analyst in Financial Economics, and (name redacted), specialist in Macroeconomic Policy.

requires the banking regulators to review the current call report and, "to the extent appropriate," develop a shorter call report. Section 1166 of H.R. 5983 requires banking regulators to develop a short form call report for highly rated and well capitalized depository institutions to use in two out of four quarters.

Background. Bank supervision is not a one-time event that occurs when the examiner visits the bank, but rather is an ongoing process that includes monitoring data collected from banks. A primary source of data is the call report, in which banks report data on various aspects of their operations using a standard definition so that data can be compared across banks by the regulators and the public.³¹² The call report is made up of various schedules, each with multiple line items, and the number of schedules and items that a bank must report depends on its size and activities.

Current statute requires the regulators to review call reports every five years in order to eliminate any information or schedule that "is no longer necessary or appropriate."³¹³ This requirement does not reference the size of the institution. The next review is due by October 13, 2016. FFIEC has announced that they are accelerating this review and expect it to take effect for the December 2015 or March 2016 call reports.³¹⁴ The bank regulators released a proposed rule in September 2015 that proposes to delete a number of items from current call reports, exempt banks with under \$1 billion in assets from four items, surveys regulators to find out the usefulness of each item on the call report, and dialogues with banks to find out the regulatory burden associated with reporting each item, among other things.³¹⁵ They are also "evaluating the feasibility and merits of creating a streamlined version of the quarterly Call Report for community institutions...."³¹⁶

Statute also required the regulators to modernize the call report process in 1994 and 2000. Included was a requirement that the regulators eliminate call report items that were "not warranted for reasons of safety and soundness or other public purposes."³¹⁷

Policy Discussion. The FDIC has argued that call reports "provide an early indication that an institution's risk profile may be changing" and are therefore important parts of the supervision process.³¹⁸ Removing too many items from the call report could mute the early warning signal it provides. Proponents of the legislation argue that call reports are currently unduly complex and burdensome for community banks with traditional business operations. The call report is currently structured to lower the burden on small banks relative to larger and more complex banks, however. The FDIC states that

The Call Report itself is tiered to size and complexity of the filing institution, in that more than one-third of the data items are linked to asset size or activity levels. Based on this tiering alone, community banks never, or rarely, need to fill out a number of pages in the Call Report, not counting the data items and pages that are not applicable to a particular bank based on its business model. For example, a typical \$75 million

³¹² Call reports can be accessed at <https://cdr.ffiec.gov/public/>.

³¹³ 12 U.S.C. §1817(a)(11).

³¹⁴ FFIEC, "FFIEC Announces Initiative to Streamline Reporting Requirements for Community Banks," press release, September 8, 2015, <http://www.ffiec.gov/press/pr090815.htm>.

³¹⁵ OCC, Federal Reserve, FDIC, "Proposed Agency Information Collection Activities," 80 *Federal Register* 56539, September 18, 2015, at <https://www.gpo.gov/fdsys/pkg/FR-2015-09-18/pdf/2015-23402.pdf>.

³¹⁶ FFIEC, "FFIEC Announces Initiative to Streamline Reporting Requirements for Community Banks," press release, September 8, 2015, <http://www.ffiec.gov/press/pr090815.htm>.

³¹⁷ 12 U.S.C. §§4805-4805a.

³¹⁸ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Ms. Doreen R. Eberley*, FDIC, 113th Cong., 2nd sess., September 16, 2014.

community bank showed reportable amounts in only 14 percent of the data items in the Call Report and provided data on 40 pages. Even a relatively large community bank, at \$1.3 billion, showed reportable amounts in only 21 percent of data items and provided data on 47 pages.³¹⁹

There are no official data on the regulatory burden associated with call reports. As evidence that the regulatory burden has increased over time, the American Bankers Association claims that the number of items required in call reports has increased from 309 in 1980 to 1,955 in 2012.³²⁰ The Independent Community Bankers of America, a trade association representing community banks, conducted a survey which found that "[a]lmost three quarters of respondents stated that the number of hours required to complete the call report had increased over the last ten years. Over one third of respondents indicated a significant increase in hours over this period. Well over three quarters of respondents noted increased costs in call report preparation with almost one third noting that costs increased significantly."³²¹ The survey showed mixed evidence of economies of scale in call report compliance. For banks with less than \$500 million in assets, costs were similar regardless of the banks' size, but for banks with more than \$500 million in assets, costs were significantly higher than for banks with less than \$500 million in assets. Because the survey was of members and members are generally small, it did not contain evidence for call report compliance costs for the largest banks, however. As noted above, regulators argue that the call reports are already tailored to reduce the burden on small banks.

Since S. 1484 leaves it to regulators to shorten the call report, and regulators are currently undergoing a statutorily required review to eliminate unnecessary items from the call report, it is unclear what additional effect S. 1484 would have beyond the current review. One could argue that it would signal to regulators that Congress desires the current review to result in a shorter call report.

CFPB Supervisory Threshold (S. 1484/S. 1910 and H.R. 5983)³²²

Section 328 of H.R. 5983 and Section 110 of S. 1484 (Section 911 of S. 1910) would increase the threshold at which insured depository institutions (including banks and savings associations) and insured credit unions would be subject to CFPB supervision from \$10 billion in total assets to \$50 billion in total assets. S. 1484 would also index the \$50 billion level to the annual change in gross domestic product.

Bank and Credit Union Regulation. Banks, savings associations, and credit unions are regulated for *safety and soundness* as well as for *consumer compliance*. Safety and soundness, or *prudential*, regulation is intended to ensure an institution is managed to maintain profitability and avoid failure. The focus of consumer compliance regulation, by contrast, is ensuring institutions conform with applicable consumer protection and fair-lending laws. Prior to the Dodd-Frank Act, the federal banking regulators (the Fed, OCC, FDIC, and NCUA) were charged with the two-pronged mandate of regulating for both safety and soundness and consumer compliance. Pursuant

³¹⁹ U.S. Congress, Senate Committee on Banking, Housing, and Urban Affairs, *Testimony of Ms. Doreen R. Eberley*, FDIC, 113th Cong., 2nd sess., September 16, 2014.

³²⁰ American Bankers Association, "An Avalanche of Regulation," infographic, at <http://www.aba.com/Issues/Index/Documents/2014RegBurdenInfographic.pdf>.

³²¹ Independent Community Bankers of America, *2014 ICBA Community Bank Call Report Burden Survey*, at <http://www.icba.org/files/ICBASites/PDFs/2014CallReportSurveyResults.pdf>.

³²² Parts of this section were adapted from CRS In Focus IF10031, *Introduction to Financial Services: The Consumer Financial Protection Bureau (CFPB)*, by (name redacted) and (name redacted).

to the Dodd-Frank Act, the CFPB acquired certain consumer compliance powers over banks and credit unions that vary based on whether the institution holds more or less than \$10 billion in assets.

For institutions with *more than \$10 billion* in assets, the CFPB is the primary regulator for consumer compliance, whereas safety and soundness regulation continues to be performed by the prudential regulator. As a regulator of larger entities, the CFPB has rulemaking, supervisory, and enforcement authorities. This means the CFPB can issue rules for a large bank to follow, examine the bank to ensure it is in compliance with these rules, and take enforcement actions (such as imposing fines) against banks that fail to comply. A large institution, therefore, has different regulators for consumer protection and safety and soundness.

For institutions with *\$10 billion or less* in assets, the rulemaking, supervisory, and enforcement authorities for consumer protection are divided between the CFPB and a prudential regulator. The CFPB may issue rules that would apply to smaller institutions from authorities granted under the federal consumer financial protection laws. The prudential regulator, however, would maintain primary supervisory and enforcement authority for consumer protection. The CFPB has limited supervisory authority over smaller institutions; it can participate in examinations of smaller entities performed by the prudential regulator "on a sampling basis." The CFPB does not have enforcement powers over small entities, but it may refer potential enforcement actions against small entities to the entities' prudential regulators (the prudential regulators must respond to such a referral but are not bound to take any other substantive steps).

Policy Discussion. Approximately 120 banks and credit unions have over \$10 billion in assets. If the threshold were increased to \$50 billion, about 80 institutions that are currently subject to CFPB supervision would no longer be, with approximately 40 institutions remaining under CFPB supervision. Though small in number, the largest institutions hold the vast majority of the industry's total assets.

Supporters of the legislative proposals to raise the CFPB threshold argue that financial institutions are subject to overly burdensome examinations that require bank managers to invest time and other resources that, the supporters believe, could be better spent elsewhere. By raising the threshold, the institutions "would still be examined by their primary regulators who are required by law to enforce the CFPB rules and regulations" but, supporters contend, the institutions "wouldn't have to go through yet another exam with the CFPB in addition to the ones they already have to go through with their primary regulators."³²³ A higher threshold could reduce the regulatory burden imposed on those banks but, in supporters' opinion, still ensure that the institutions would be examined for consumer compliance.

Critics of the proposal noted that exam cycles could be better coordinated to reduce the burden institutions faced, but did not support raising the CFPB threshold. They argue that some of the banks in the asset range that would no longer be primarily supervised by the CFPB were, in critics' opinions, "some of the worst violators of consumer protections" in the housing bubble, with IndyMac at approximately \$30 billion in assets a highlighted example.³²⁴ Raising the threshold could lead to those entities being subject to less-intensive consumer compliance

³²³ Attributed to Senator Toomey by CQ Congressional Transcripts, "Senate Banking, Housing and Urban Affairs Committee Holds Markup on the Financial Regulatory Improvement Act," May 21, 2015, at <http://www.cq.com/doc/congressionaltranscripts-4691548?8&search=Re1SwoJi>.

³²⁴ Attributed to Senator Brown by CQ Congressional Transcripts, "Senate Banking, Housing and Urban Affairs Committee Holds Markup on the Financial Regulatory Improvement Act," May 21, 2015, at <http://www.cq.com/doc/congressionaltranscripts-4691548?8&search=Re1SwoJi>.

supervision (though it would not affect the consumer protection rules with which an entity would be required to comply, just the supervision).

Operation Choke Point (H.R. 766, H.R. 5983, H.R. 2578, S.Con.Res. 11, and S. 1484/S. 1910)³²⁵

Operation Choke Point (OCP) was a Department of Justice (DOJ) initiative aimed at curbing Internet fraudsters operating in conjunction with third-party payment processors.³²⁶ It is the subject of numerous bills. Section 126 of S. 1484 (Section 927 of S. 1910) would prohibit the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve, the Bureau of Consumer Financial Protection, and the National Credit Union Administration from implementing or participating in Operation Choke Point.

The Financial Institution Consumer Protection Act of 2015 (H.R. 766) passed the House on February 4, 2016. It was also included in Title 11 of H.R. 5983. It would bar banking regulators from formally requesting or informally suggesting that a depository bank close customer accounts unless the regulators have a *material reason*³²⁷ for the request, which cannot be based solely on reputational risk. The bill also identifies several threats that could satisfy the material reason requirement; specifically, if the customer

- poses a threat to national security;
- is engaged in terrorism financing;
- is doing business with Iran, North Korea, Syria, or another State Sponsor of Terrorism;³²⁸ or
- is doing business with an entity in any of those countries.

The bill would require depository institutions to inform their customers of the justification for account termination. The bill would also require the regulators to report annually to Congress the number of accounts terminated at the request of the regulator and the legal justification for the request.

Other legislative proposals also address OCP. The Commerce, Justice, Science, and Related Agencies Appropriations Act, 2016 (H.R. 2578), which passed the House on June 3, 2015, would prohibit funds provided by H.R. 2578 from being used for OCP. The budget resolution for FY2016 (S.Con.Res. 11) includes a provision for a non-binding deficit-neutral reserve fund to end OCP.³²⁹

³²⁵ This section was written by (name redacted), analyst in Financial Economics.

³²⁶ For additional information see CRS Legal Sidebar WSLG1023, *FDIC Moves to Modify Guidance "Choking" Banking Services for Certain Legitimate Businesses*, by (name redacted).

³²⁷ The bill does not define "material reason," but states that it could be based on a banking regulator's belief that a specific customer or a group of customers pose a threat to national security, including any belief that they are involved in terrorist financing.

³²⁸ U.S. Department of State, *State Sponsors of Terrorism*, at <http://www.state.gov/j/ct/list/c14151.htm>.

³²⁹ Congress frequently includes "reserve funds" in the budget resolution. Such provisions provide the chairs of the House or Senate Budget Committees the authority to adjust the budgetary allocations, aggregates, and levels included in the budget resolution in the future if certain conditions are met. Typically, these conditions consist of legislation dealing with a particular policy being reported by the appropriate committee or an amendment dealing with that policy being offered on the floor. Generally, the goal of such a reserve fund or adjustment is to allow certain policies to be considered on the floor without triggering a point of order for violating levels in the budget resolution. For a detailed (continued...)

Operation Choke Point. According to DOJ, OCP's stated goal was "to attack Internet, telemarketing, mail, and other mass market fraud against consumers, by choking fraudsters' access to the banking system."³³⁰ While OCP remained a DOJ initiative, DOJ did communicate with other law enforcement agencies and financial regulators to ensure it had all the information needed to evaluate the enforcement options available to address the violations.³³¹ The operation held banks and payments processors accountable for processing transactions that they knew were fraudulent.³³² Fraud may be committed by scammers who take advantage of increased online commerce to systemically extract money from consumers' bank accounts. According to DOJ, once a fraudulent merchant enters the banking system, they can debit consumers' bank accounts and credit their own account repeatedly, without permission and in violation of federal law, unless someone stops them.³³³ The DOJ has sought legal action in certain circumstances that has resulted in civil monetary penalty fees levied against financial institutions who, despite indications of fraud, continued to process fraudulent merchant transactions in violation of federal law.³³⁴

Policy Discussion. One of the major issues related to OCP is whether it affected businesses that are lawful and legitimate. Allegedly, DOJ and bank regulators labeled certain firms as high-risk, including credit repair companies, debt consolidation and forgiveness programs, online gambling-related operations, government-grant or will-writing kits, pornography, online tobacco or firearm sales, pharmaceutical sales, sweepstakes, magazine subscriptions, and payday or subprime loans. Certain bank regulators also considered some of these merchants to pose a *reputational risk*³³⁵ to the financial institutions that provide services to these merchants.³³⁶ Federal banking regulators have also supported DOJ efforts either through guidance or policy statements. As an example, the Federal Deposit Insurance Corporation's *Guidance on Payment Processor Relationships* recommended banks to conduct heightened scrutiny of certain types of accounts.³³⁷

(...continued)

description of reserve funds, see CRS Report R43535, *Provisions in the Bipartisan Budget Act of 2013 as an Alternative to a Traditional Budget Resolution*, by (name redacted).

³³⁰ G. Bradley Weinsheimer, *OPR Inquiry Regarding Operation Choke Point*, U.S. Department of Justice—Office of Professional Responsibility, July 7, 2015, p. 4.

³³¹ U.S. Congress, House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial And Antitrust Law, *Guilty Until Proven Innocent? A Study of the Propriety and Legal Authority for the Justice Department's Operation Choke Point*, Statement of Stuart F. Delery, Assistant Attorney General Civil Division, 113th Cong., 2nd sess., July 17, 2014, pp. 1-3.

³³² Reportedly, Operation Choke Point was conceived in by the Department of Justice in 2012 and began in early 2013. Michael J. Bresnickat, *Justice News—Financial Fraud Enforcement Task Force*, The U.S. Department of Justice, March 20, 2013, at <http://www.justice.gov/opa/speech/financial-fraud-enforcement-task-force-executive-director-michael-j-bresnick-exchequer>.

³³³ U.S. Congress, House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial And Antitrust Law, *Guilty Until Proven Innocent? A Study of the Propriety and Legal Authority for the Justice Department's Operation Choke Point*, Statement of Stuart F. Delery, Assistant Attorney General Civil Division, 113th Cong., 2nd sess., July 17, 2014, pp. 1-2.

³³⁴ U.S. Congress, House Committee on the Judiciary, Subcommittee on Regulatory Reform, Commercial And Antitrust Law, *Guilty Until Proven Innocent? A Study of the Propriety and Legal Authority for the Justice Department's Operation Choke Point*, Statement of Stuart F. Delery, Assistant Attorney General Civil Division, 113th Cong., 2nd sess., July 17, 2014, pp. 1-2.

³³⁵ Federal Deposit Insurance Corporation, Office of Inspector General, *The FDIC's Role in Operation Chokepoint*, Report no. AUD-15-008, September 2015, p. iii, at <https://www.fdicig.gov/reports15%5C15-008AUD.pdf>.

³³⁶ U.S. Congress, House Committee on Oversight and Government Reform, *The Department of Justice's "Operations Choke Point": Illegally Choking Off Legitimate Businesses?*, Staff Report, 113th Cong., 2nd sess., May 29, 2014, pp. 1-8.

³³⁷ Federal Deposit Insurance Corporation, Office of Inspector General, *The FDIC's Role in Operation Chokepoint*, (continued...)

Some have argued that, contrary to DOJ public statements, OCP was primarily focused on the payday lending industry.³³⁸ In addition, they contend that DOJ was pressuring banks to shut down accounts without proving the merchants using the banking services broke the laws. They further assert that, in instances when the banks did not shut down the accounts, DOJ has penalized the banks for wrongdoing that may or may not have happened.³³⁹

Based on the staff report by the Committee on Oversight and Government Reform and a letter from Members of Congress,³⁴⁰ DOJ's Office of Professional Responsibility performed a review of OCP. The review concluded that

Department of Justice attorneys did not improperly target lawful participants involved in the Internet payday lending industry.... To the extent that Civil Division attorneys involved in Operation Choke Point investigated Internet payday lending, their focus appeared to be on only a small number of lenders they had reason to suspect were engaged in fraudulent practices.³⁴¹

The review found some evidence indicating that "some of the congressional and industry concerns relating to Internet payday lending was understandable," including some DOJ memoranda disparaging payday lending and emails indicating that "some of the attorneys ... working on Operation Choke Point may have viewed Internet payday lending in a negative light."³⁴² The review "did not find evidence of an effort to improperly pressure lawful businesses," although it did find that "attorneys at one point did enclose with ... subpoenas ... regulatory guidance from federal regulators, including one document that contained a footnote listing businesses that the FDIC had described as posing an 'elevated risk.'"³⁴³ The review concluded OCP did not compel banks to terminate their relationship with legitimate businesses.³⁴⁴ In addition, an audit by the FDIC's Inspector General found the "FDIC's involvement in Operation Choke Point to have been inconsequential to the overall direction and outcome of the initiative."³⁴⁵

To address concerns raised by Congress and the financial services industry about OCP, FDIC issued new guidance and removed the list of examples of merchants categories that were considered high risk. Further, FDIC has established dedicated email, and a toll-free number for

(...continued)

Report no. AUD-15-008, September 2015, p. ii, at <https://www.fdicig.gov/reports15%5C15-008AUD.pdf>.

³³⁸ U.S. Congress, House Committee on Oversight and Government Reform, *The Department of Justice's "Operations Choke Point": Illegally Choking Off Legitimate Businesses?*, Staff Report, 113th Cong., 2nd sess., May 29, 2014, pp. 1-8.

³³⁹ U.S. Congress, House Committee on Oversight and Government Reform, *The Department of Justice's "Operation Chokepoint": Illegally Choking Off Legitimate Businesses*, 113th Cong., 2nd sess., May 29, 2014.

³⁴⁰ G. Bradley Weinsheimer, *OPR Inquiry Regarding Operation Choke Point*, U.S. Department of Justice—Office Of Professional Responsibility, July 7, 2015, pp. 4-5.

³⁴¹ *Ibid.*, at 40-41.

³⁴² *Ibid.*, at 41.

³⁴³ *Ibid.* According to the review by the Department of Justice Office of Professional Responsibility, there was evidence that "that the attorneys had a legitimate reason for including such regulatory guidance."

³⁴⁴ G. Bradley Weinsheimer, *OPR Inquiry Regarding Operation Choke Point*, U.S. Department of Justice—Office Of Professional Responsibility, July 7, 2015, pp. 4-5.

³⁴⁵ FDIC, Office of Inspector General, *The FDIC's Role in Operation Chokepoint*, Report no. AUD-15-008, September 2015, p. ii, <https://www.fdicig.gov/reports15%5C15-008AUD.pdf>.

the Office of the Ombudsman for institutions to address any concerns raised by FDIC-supervised institutions about OCP.³⁴⁶

CBO's cost estimates for H.R. 766 as ordered to be reported determined that the legislative proposals would have no effect on the federal budget.³⁴⁷

Capital Issuance

Banks face regulations surrounding how they can raise capital from investors, and what rights are conferred to investors. Capital can take various forms depending on the ownership structure of the institution. For example, publicly held banks issue stock that can be traded on exchanges. Disclosure requirements and investor protections may better inform investors about the risks that they are assuming, but can make it more costly for institutions to raise capital, and those costs might be passed on to customers in the form of higher fees or interest rates charged. While some view these existing regulatory requirements as important safeguards that ensure that investors are protected from fraud, others see them as unnecessary red tape that makes it too difficult for banks to raise the capital needed to expand or remain healthy.

Holding Company Registration Threshold Equalization (H.R. 22, H.R. 37, H.R. 1334, and S. 1484/S. 1910)³⁴⁸

Five bills that have seen congressional action would raise the exemption threshold on the Securities and Exchange Commission's (SEC's) registration for thrift holding companies to match the current exemptions for bank holding companies (BHCs). The proposal is found in the Holding Company Registration Threshold Equalization Act (H.R. 1334), which passed the House on July 15, 2015; Title III of the Promoting Job Creation and Reducing Small Business Burdens Act (H.R. 37), which passed the House on January 14, 2015; and Section 601 of S. 1484 (which is also Section 971 of S. 1910). It was enacted in Title LXXXV of the Fixing America's Surface Transportation Act (H.R. 22/P.L. 114-94).

Background. Historically, under the Securities Act of 1933,³⁴⁹ banks and BHCs, similar to nonfinancial firms, generally were required to register securities with the SEC if they had total assets exceeding \$10 million and the shares were held (as per shareholders of record) by 500 shareholders or more. Banks and BHCs also were allowed to stop registering securities with the SEC, a process known as *deregistration*, if the number of their shareholders of record fell to 300 shareholders or fewer.

Title VI of the Jumpstart Our Business Startups Act (JOBS Act)³⁵⁰ raised the SEC shareholder registration threshold from 500 shareholders to 2,000 shareholders and increased the upper limit

³⁴⁶ U.S. Congress, House Committee on Financial Services, Subcommittee on Oversight and Investigations, *The Federal Deposit Insurance Corporation's Role in Operation Choke Point*, Statement of Martin J. Gruenberg, 114th Cong., 1st sess., March 24, 2015, <http://financialservices.house.gov/uploadedfiles/hhrg-114-ba09-wstate-mgruenberg-20150324.pdf>.

³⁴⁷ CBO, *Cost Estimate: H.R. 766 Financial Institution Customer Protection Act of 2015, as ordered reported by the House Committee on Financial Services on July 29, 2015*, September 4, 2015, at <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/hr766.pdf>.

³⁴⁸ This section was authored by (name redacted), specialist in Financial Economics.

³⁴⁹ P.L. 73-22.

³⁵⁰ P.L. 112-106.

for deregistration from 300 shareholders to 1,200 shareholders for those banks and nonfinancial firms. In other words, the JOBS Act made it easier for banks and BHCs to increase the number of their shareholders while remaining unregistered private banks and, if already registered, to voluntarily deregister while also adding more shareholders. The provision went into effect immediately upon the enactment of the JOBS Act on April 5, 2012.

These changes made by the JOBS Act did not apply to savings and loan holding companies (SLHCs). The Holding Company Registration Threshold Equalization provisions amended the Securities Exchange Act of 1934³⁵¹ by extending the higher registration and deregistration shareholder thresholds in the JOBS Act for banks and BHCs to SLHCs. Savings and loans (also known as thrifts and savings banks) are similar to banks in that they take deposits and make loans, but their regulation is somewhat different. Over time, the differences between banks and savings and loans have narrowed.³⁵² Under the provision, an SLHC would be required to register with the SEC if its assets exceed \$10 million and it has 2,000 shareholders of record, up from the current requirement of 500 shareholders of record. SLHCs that want to deregister from the SEC would have to have no more than 1,200 shareholders of record, an increase over the current 300 or fewer shareholders.

Policy Discussion. Generally speaking, the central perceived benefit of SEC registration is to enhance investor protection by ensuring that investors have access to significant financial and nonfinancial data about firms and the securities they issue. The cost of SEC registration is the regulatory burden on the firm issuing securities associated with complying with SEC requirements, which potentially raises the cost of capital and reduces how much capital a firm can raise. For small firms, the regulatory burden of registration is thought to be greater than for larger firms.³⁵³

Policymakers attempt to reach the optimal trade-off between costs and benefits of SEC registration by exempting firms below a certain size from registration requirements. The JOBS Act raised this threshold for banks, modifying the balance between costs and benefits.

Reports indicate that after passage of the JOBS Act, a number of privately held banks and BHCs took advantage of Title VI's reduction in shareholder ownership registration triggers by raising capital from additional shareholders without having to register with the SEC.³⁵⁴ Some banks also have taken the opportunity to deregister from the SEC.³⁵⁵ One of the few studies on changes to the financial health of banks that took advantage of the JOBS Act threshold changes to deregister found that the act was generally, but not entirely, financially beneficial to banks. For example, it found that, on average, the legislation resulted in \$1.31 in higher net bank income and \$3.28 lower pretax expenses for every \$1.00 of bank assets and was responsible for \$1.54 million in

³⁵¹ P.L. 73-291.

³⁵² See CRS Report R42572, *The Consumer Financial Protection Bureau (CFPB): A Legal Analysis*, by (name redacted) .

³⁵³ See Independent Community Bankers of America (ICBA), "ICBA Statement on Senate Passage of JOBS Act," press release, March 22, 2012, at <http://www.icba.org/news/newsreleasedetail.cfm?ItemNumber=123582>.

³⁵⁴ For example, see ICBA, "Key JOBS Act Provision Must Be Addressed to Benefit Thrifts," press release, September 13, 2012, at <http://www.icba.org/files/ICBASites/PDFs/test091312.pdf>.

³⁵⁵ For example, see Jeff Blumenthal, "100-plus Banks Deregister Stock since JOBS Act," *Philadelphia Business Journal*, February 15, 2013, at <http://www.bizjournals.com/philadelphia/print-edition/2013/02/15/100-plus-banks-deregister-stock-since.html>; Brian Yurcan, "Small Banks Deregister in Drove Due to JOBS Act," *Bank Tech*, May 30, 2012, at <http://www.banktech.com/compliance/small-banks-deregister-in-drove-due-to-jobs-act/d/d-id/1295425>.

increased assets per bank employee.³⁵⁶ The study did not attempt to estimate the costs to investors of reduced disclosure under the changes made by the JOBS Act.

In potentially expanding the exemption threshold on SEC registration for thrift holding companies, there are two main points to consider. First, should exemption levels from SEC registration requirements be different for thrifts and savings and loans than for banks? Current law makes it more difficult for small thrifts to raise capital than for small banks. Second, are the costs and benefits of registration requirements for small banks better balanced at the higher thresholds enacted for banks in the JOBS Act or the lower thresholds in current law for thrifts?

Mutual Holding Company Dividend Waivers (S. 1484/S. 1910)³⁵⁷

Section 113 of S. 1484 (Section 914 of S. 1910) addresses the issue of how dividends are allocated among the shareholders of mutual holding companies or their subsidiaries. It would authorize all MHCs to waive the “receipt of dividends declared on the common stock of their bank or mid-size holding company” without having to comply the Federal Reserve’s regulation regarding “Mutual Holding Company Dividend Waivers.”³⁵⁸

Mutual Holding Companies (MHCs). Section 107 of the Competitive Equality Banking Act of 1987³⁵⁹ provided for the formation of Mutual Holding Companies (MHCs). MHCs are savings and loan holding companies in mutual form, some of which own mutually held federally insured savings and loan associations, and state-chartered mutual savings banks. Most banks in the United States are held either publicly or privately by shareholders. In contrast, a mutual company or mutual savings bank (association) is one that is owned by its members. In the instance of a mutual savings bank, the members are the financial institution’s depositors.³⁶⁰ A mutual savings bank can reorganize itself into an MHC by transferring all of the assets and liabilities to a newly formed stock institution, the majority shares of which are owned by the MHC. The remaining minority shares are sold to equity investors, with depositors afforded the right to buy minority equity interest before it is made available to the public.³⁶¹

The Dodd-Frank Act transferred authority over savings and loan holding companies regulated by the Office of Thrift Supervision (OTS) to the Federal Reserve³⁶² and included a specific provision which requires a MHC to follow certain procedures in order to waive receipt of any dividend declared by a subsidiary.³⁶³ Dividends are distribution of earnings (profits) to shareholders, which are usually declared and paid quarterly. The board of directors determines the amount of dividends. If the MHC waives the right to receive dividends, depending upon the specifics of an

³⁵⁶ Joshua Mitts, *Did the JOBS Act Benefit Community Banks? A Regression Discontinuity Study*, April 25, 2013, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2233502.

³⁵⁷ This section was written by (name redacted), analyst in Financial Economics.

³⁵⁸ Section 113 of S. 1484 refers to 12 C.F.R. §239.63 “or any successor thereto.” The successor to 12 C.F.R. §239.63 is 12 C.F.R. §239.8(d).

³⁵⁹ P.L. 100-86.

³⁶⁰ The discussion surrounding Mutual Holding Companies (MHC’s) in this report are from the perspective of an MHC that has a bank as a subsidiary. U.S. Securities and Exchange Commission, “*Mutual-to-Stock*” *Conversions: Tips for Investors*, October 6, 2011, <http://www.sec.gov/investor/pubs/mutualconversion.htm>.

³⁶¹ The Securities and Exchange Commission, *Mutual to Stock Conversions: Tips for Investors*, October 6, 2011, <http://www.sec.gov/investor/pubs/mutualconversion.htm>.

³⁶² The Office of Thrift Supervision ceased to exist as of 2011.

³⁶³ §625 of P.L. 111-203, adding 12 U.S.C. §1467a(o)(11).

institution's dividend arrangements, dividends may be distributed among the other equity holders or retained by the bank subsidiary.

The Federal Reserve issued Regulation MM, implementing its authority over MHCs³⁶⁴ and included in it a subsection, 12 C.F.R. 239.8(d), implementing the statutory requirements permitting MHCs to waive the right to receive dividends declared by a subsidiary of the MHC. Under the Federal Reserve regulations,

an MHC may waive the right to receive any dividend declared by a subsidiary ... if (i) no insider of the MHC, associate of an insider, or tax-qualified or non-tax-qualified employee stock benefit plan of the MHC holds any share of the stock in the class of stock to which the waiver would apply, or (ii) the MHC gives written notice to the ... [Federal Reserve] of the intent of the MHC to waive the right to receive dividends ... and the [Federal Reserve] Board does not object.³⁶⁵

The regulation specifies what must be included in the notice of waiver, including documentation of the MHC's conclusion that a waiver would be consistent with the fiduciary duties of the board of directors of the MHC.

The Dodd-Frank Act and the Federal Reserve regulation include a streamlined approval process for dividend waivers by certain "grandfathered MHC's." Under the statute, the Federal Reserve may not object to a proposed waiver of dividends for an MHC that waived dividends prior to December 1, 2009, (grandfathered MHC's) provided "the waiver would not be detrimental to the safe and sound operation of the ... [mutual savings bank]"; and, the MHC's board "expressly determines the waiver to be consistent with its fiduciary duties to the mutual members of the MHC."³⁶⁶ For MHCs that do not meet the criteria for grandfathering, Regulation MM specifies conditions under which the Federal Reserve will not object to a waiver of dividends for non-grandfathered MHCs. Among them are a vote of the members of the MHC approving the waiver of dividends; a determination that the mutual savings bank is operating in a safe and sound manner, which will not be jeopardized by the waiver; and an affirmation that the MHC is able to meet any obligations in connection with any loan for which the MHC has pledged the stock of the subsidiary mutual savings bank.³⁶⁷

Policy Discussion. In prior circumstances, the Federal Reserve identified a number of issues related to dividend waivers by the holding company. One of the reasons for retaining dividends is so the MHC could serve as a source of strength to its subsidiary bank. If the MHC retains the dividend payments from the subsidiary, then an MHC can transfer its excess capital to the subsidiary when the subsidiary might need a capital infusion.³⁶⁸ If there is no requirement for a mandatory vote of MHC shareholders, the waiver would rest exclusively with the MHC's board, who may have a financial interest in the waiver as minority shareholders in the bank.

In issuing the regulations implementing the Dodd-Frank dividend waiver provisions, the Federal Reserve also noted that dividend waiver by the MHC without corresponding waiver by the minority (i.e., non-member) shareholders poses an "inherent conflict of interest" because it might result in unequal distribution of equity between mutual owners of the MHC and minority

³⁶⁴ Federal Reserve, "Savings and Loan Holding Companies," 76 *Federal Register* 56511-56513, September 13, 2011.

³⁶⁵ Federal Reserve, "Savings and Loan Holding Companies," 76 *Federal Register* 56508, 56521, September 13, 2011.

³⁶⁶ 12 U.S.C. §1467a(o)(11)(D).

³⁶⁷ 12 C.F.R. §239.8(d)(4).

³⁶⁸ Federal Reserve Bank of St. Louis, *Order Approving Formation of a Holding Company and Acquisition of Nonbanking Subsidiaries—Northwest Bancorp, MHC.*, Federal Reserve Bulletin, December 1994, pp. 1131-1133.

shareholders. In essence, it could result in a transfer of equity from mutual owners to minority shareholders.³⁶⁹

Supporters of S. 1484 cite similar reasons as those that opposed the implementation of Regulation MM's dividend waiver requirements in 2011.³⁷⁰ They fear that the Fed will erroneously block waivers under Regulation MM, thereby harming MHCs and discouraging capital formation. They assert that if the MHC waives the dividends, greater capital is retained by the subsidiary, which would enhance the safe and sound operation of the subsidiary savings bank. Further, they state, waiving dividends for majority shareholders while retaining them for minority shareholders may be necessary in order to offer the latter a market rate of return. Lastly, the supporters state that when the MHC receives the dividends from the subsidiary it must pay taxes on the dividends received, thereby reducing the overall franchise value.³⁷¹

The supporters of S. 1484 also state that distinguishing between grandfathered MHCs and the rest of the MHCs leads to different classes of MHCs. They also assert that the cost of obtaining the vote of the members could be cost prohibitive and lead to additional unnecessary administrative and financial costs.³⁷²

Previously, in similar circumstances, the banking regulators have allowed waiver of dividends by the MHC and those dividends to be retained by the bank. In such instances, the regulators required specific accounting procedures to allocate the value of those dividends to the members of the mutual institution. This process helped delineate the increase in value of the MHC to be properly apportioned between the members and minority shareholders.³⁷³

³⁶⁹ The Board of Governors of the Federal Reserve, "Savings and Loan Holding Companies," 76 *Federal Register* 56512, September 2011.

³⁷⁰ America's Mutual Holding Companies, *FAQ's America's Mutual Holding Companies*, <http://www.americasmutualholdingcompanies.com/faq.html>.

³⁷¹ Luse Gorman Pomerenk & Schick, "Comments on Section 239.8(d) of Regulation MM of the Interim Final Rule Regarding Dividend Waivers by Mutual Holding Companies—Docket No. R-1429; RIN No. 7100 AD80," November 1, 2011, at <http://www.luselaw.com/publications/2011/Ltr%20to%20FRB%20re%20public%20comments%20to%20Regulation%20MM%20%2800093534%29.PDF>.

³⁷² *Ibid.*

³⁷³ Federal Reserve, "Order Approving Formation of a Holding Company and Acquisition of Nonbanking Subsidiaries—Northwest Bancorp, MHC.," *Federal Reserve Bulletin*, December 1994, pp. 1131-1133.

Appendix A. Indexing of Bank Regulatory Relief Provisions for GDP Growth

Certain provisions of S. 1484/S. 1910 with exemptions based on size are indexed by "such amount is adjusted annually ... to reflect the percentage change for the previous calendar year in the gross domestic product of the United States, as calculated by the Bureau of Economic Analysis of the Department of Commerce." Indexing reduces the number of firms that "graduate" from the exemption over time as they grow in size, in nominal or real terms. Nominal price increases are caused by inflation, whereas real price increases refer to those in excess of the inflation rate. **Table A-1** summarizes those provisions that apply to banks.

Table A-1. Provisions Indexed for GDP Growth

Section of S. 1484	Section of S. 1910	Topic	Current and Proposed Threshold (billions)
110(a)	911(a)	Exemption from swap clearing requirements for banks, savings associations, farm credit system institutions, and credit unions below the threshold	\$10
110(b)	911(b)	Depository institutions and credit unions above the threshold subject to CFPB supervision	\$10 to \$50
110(c)	911(c)	Exemption from security-based swap clearing requirements for banks, savings associations, farm credit system institutions, and credit unions below the threshold	\$10
110(d)	911(d)	Exemption from debit interchange fee restrictions for issuers below the threshold ("Durbin Amendment")	\$10
110(e)	911(e)	Offset of increased deposit insurance assessments for banks below the threshold	\$10
110(f)	911(f)	Exemption from executive compensation standards for depository institutions, broker-dealers, credit unions, investment advisors, Fannie Mae, Freddie Mac, and other financial institutions designated by regulators below the threshold	\$1
115	916	Exemption from Volcker Rule for banks below the threshold	\$10
201	931	Exemption from enhanced prudential regulation for bank holding companies below \$50 billion, eligible for designation if between \$50 billion and \$500 billion, automatically subject to enhanced prudential regulation if above \$500 billion	\$50, \$500
202	932	Risk committee requirements apply to publicly traded bank holding companies above the threshold	\$10 to \$50
202	932	Company-run stress test requirements apply to banks above the threshold	\$10 to \$50
n/a	928	Grants regulators discretion to exempt banks below the threshold from certain regulations	\$10

Source: CRS analysis.

Note: Threshold is based on total assets, unless otherwise noted.

Section 110 of S. 1484 (Section 911 of S. 1910) indexes exemptions found in a few provisions of existing law (all added by the Dodd-Frank Act) while making no other changes to those

provisions, except 110(b), which also raised the threshold and is discussed in the section above entitled "CFPB Supervisory Threshold." The other exemptions are found within other sections of the bills that make broader changes to current law. In addition, Section 108 of S. 1484 (Section 909 of S. 1910) indexed thresholds for exemptions from points and fees for manufactured housing for inflation (as measured by the consumer price index) instead of GDP.

GDP is revised repeatedly and is not available on the first of the year, so regulators would have to formulate a method for making this calculation. The bills do not specify whether regulators should use the nominal or real GDP growth rate—nominal GDP growth is equal to real GDP growth plus the inflation rate. If regulators used the real GDP growth rate, GDP in some years could be negative or lower than the inflation rate. In most years, GDP grows faster than inflation, so the thresholds would be increasing in real terms over the long run. Total assets of the financial system also generally increase more rapidly than inflation, so indexing by GDP growth instead of inflation would make it less likely that an increasing number of firms would not be subject to the exemption over time.

Appendix B. Provisions in the Financial Regulatory Improvement Act Covered in this Report

Table B-1 lists the provisions in S. 1484, the Financial Regulatory Improvement Act, that are covered in this report and the corresponding section in S. 1910, Financial Services and General Government Appropriations Act, 2016, and related House bills.

Table B-1. Provisions in the Financial Regulatory Improvement Act Covered in this Report

Subject	S. 1484	S. 1910	Related House Bill
Privacy Notifications	Section 101	Section 902	H.R. 601, H.R. 22
Rural Lending	Section 103	Section 904	H.R. 1259, H.R. 22
Exam Ombudsman and Appeals Process	Section 104	Section 905	H.R. 1941, H.R. 5983
Portfolio Qualified Mortgage	Section 106	Section 907	H.R. 1210, H.R. 5983
Points and Fees	Section 107	Section 908	H.R. 685, H.R. 5983
Manufactured Housing	Section 108	Section 909	H.R. 650, H.R. 5983
Exam Frequency for Small Banks	Section 109	Section 910	H.R. 1553, H.R. 22
CFPB Supervisory Threshold	Section 110	Section 911	H.R. 5983
Mutual Holding Company Dividend Waivers	Section 113	Section 914	—
Volcker Rule, Exemption for Community Banks	Section 115	Section 916	—
Capital Treatment of Mortgage Servicing Assets	Section 116	Section 917	H.R. 1408
Integrated Disclosure Forms	Section 117	Section 918	H.R. 3192
Call Report Reform	Section 119	Section 920	H.R. 5983
Change to the “Collins Amendment”	Section 123	Section 924	H.R. 22
EGRPRA Process	Section 125	Section 926	—
Operation Choke Point	Section 126	Section 927	H.R. 766, H.R. 2578, H.R. 5983
Enhanced Regulation of Large Banks	Section 201	Section 931	H.R. 1309, H.R. 6392
Holding Company Registration Threshold Equalization	Section 601	Section 971	H.R. 37, H.R. 22, H.R. 1334

Source: Table created by CRS.

Notes: S. 1910, Section 928 (“Exemptive Authority”) is the only provision of S. 1910 discussed in this report that was not originally part of S. 1484. “Related House Bill” only includes bills covered in this report.

Appendix C. Provisions in the Financial CHOICE Act Covered in this Report

Table C-1 lists the provisions in H.R. 5983, the Financial CHOICE Act, that are covered in this report and related House and Senate bills.

Table C-1. Provisions in the Financial CHOICE Act Covered in this Report

Subject	H.R. 5983	Related Bills
Leverage Ratio as an Alternative to Current Bank Regulation	Sections 101 and 102	—
Enhanced Regulation of Large Banks	Section 211	—
CFPB Supervisory Threshold	Section 328	S. 1484/S. 1910
Durbin Amendment Repeal	Section 335	—
Volcker Rule Repeal	Section 901	—
Manufactured Housing	Sections 1101 and 1102	H.R. 650, S. 1484/S. 1910
Points and Fees	Section 1106	H.R. 685, S. 1484/S. 1910
Operation Choke Point	Sections 1111 and 1112	H.R. 766, H.R. 2578, S.Con.Res. 11, S. 1484/S. 1910
Portfolio Qualified Mortgage	Section 1116	H.R. 1210, S. 1484/S. 1910
Small Bank Holding Company Policy Threshold	Section 1126	H.R. 3791
Mortgage Escrow and Servicing	Section 1131	H.R. 1529
Exam Ombudsman and Appeals Process	Section 1136	H.R. 1941, S. 1484/S. 1910
Authority to Provide Exemptions or Tailoring from Regulations	Section 1146	H.R. 2896, S. 1910
Optional Expanded Charter for Thrifts	Section 1151	H.R. 1660
Call Report Reform	Section 1166	S. 1484/S. 1910

Source: Table created by CRS.

Notes: Related Bills only includes bills covered in this report.

Appendix D. Provisions in the Fixing America's Surface Transportation Act Covered in this Report

H.R. 22, the Fixing America's Surface Transportation Act, was signed into law as P.L. 114-94 on December 4, 2015. Division G of H.R. 22 contained 19 titles related to financial services. **Table D-1** lists the provisions of Division G that are covered in this report and the corresponding section in S. 1484 and related House bills.

Table D-1. Provisions in the Fixing America's Surface Transportation Act Covered in this Report

Subject	Title of H.R. 22	Section of S. 1484	Related House Bill
Privacy Notifications	LXXV	101	H.R. 601
Exam Frequency for Small Banks	LXXXIII	109	H.R. 1553
Holding Company Registration Threshold Equalization	LXXXV	601	H.R. 37, H.R. 3791
Change to the "Collins Amendment"	LXXXVII	123	—
Rural Lending	LXXXIX	103	H.R. 1259

Source: Table created by CRS.

Author Contact Information

(name redacted), Coordinator
Analyst in Financial Economics
[redacted]@crs.loc.gov7-....

(name redacted)
Specialist in Financial Economics
[redacted]@crs.loc.gov7-....

(name redacted)
Analyst in Financial Economics
[redacted]@crs.loc.gov , 7-....

(name redacted)
Specialist in Macroeconomic Policy
[redacted]@crs.loc.gov 7-....

(name redacted)
Specialist in Financial Economics
[redacted]@crs.loc.gov7-....

(name redacted)
Specialist in Financial Economics
[redacted]@crs.loc.gov7-....

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