



## **The Easy Legislative Fix that Could Save Community Banks**

**By Rob Blackwell**

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WASHINGTON — Call it the Sheila Bair Small Bank Regulatory Relief Act of 2015.

The former chairman of the Federal Deposit Insurance Corp. is calling for a legislative solution she argues could significantly diminish regulatory burden on community banks: giving regulators the power to exempt institutions with less than \$10 billion of assets from existing and new regulations.

Doing so would make it far easier for the agencies to carve out small banks from regulations like the Volcker Rule or Basel III that many policymakers — and even regulators themselves — say should only be applied to larger institutions.

"That might give regulators the ability to craft simpler rules for banks with much simpler business models," said Bair, who raised the idea during an interview with American Banker.

Small banks are currently lobbying Congress for regulatory relief, arguing that many of the new rules instituted by the Dodd-Frank Act are causing compliance costs to skyrocket and forcing many to consider mergers. But their requests generally focus on specific areas they are hoping lawmakers will address, like requirements to send privacy notices and a change in how mortgage servicing rights are treated in capital rules.

Bair said bankers should push for a broader solution, one that could fix many of those problems and future ones that arise. She said too often regulators feel like they have to start applying regulations geared for larger institutions to smaller ones.

"There is this fear that if you don't do something you are going to look weak if you aren't dealing with the small banks the same way as big banks," she said.

But if Congress provided an explicit directive to regulators to consider granting small banks an exemption from rules they implement, that trend could begin to turn around. It would allow

regulators to craft streamlined rules for small banks, effectively giving a stamp of approval to a two-tiered regulatory system, a concept that many lawmakers already endorse.

"This might inform more of a two-tiered approach," Bair said. "It's clean, simple, easy to write... I don't know why anyone would object to it."

It would also empower regulators to act rather than having them return to Congress asking for an exemption. That is currently the case with the Volcker Rule, a Dodd-Frank provision that places limits on bank investment in private equity and hedge funds. Fed officials have asked Congress to exempt small banks from the rule.

Regulators are also already required by the Economic Growth and Regulatory Paperwork Reduction Act to review regulations every 10 years and identify outdated ones. However, even once they do so, any most suggested regulatory changes would likely require Congressional approval.

Whether Bair's idea will catch on with lawmakers is unclear, but several observers said it has the potential to be very popular with members of both political parties.

"It's a great concept to throw out there," said Mark Calabria, director of financial regulation studies at the Cato Institute and a former top aide to Senate Banking Committee Chairman Richard Shelby. "There's probably 60 votes for it" in the Senate.

It might even address concerns of progressive Democrats like Sen. Elizabeth Warren, who fear that small bank regulatory relief bills are often used to surreptitiously grant relief to larger institutions. By limiting the relief regulators could grant to banks with less than \$10 billion of assets, big banks could not benefit, Bair said.

"It removes community bank relief as a stalking horse for rollbacks that are being pursued by larger institutions," she said.

Additionally, the proposal effectively bypasses the argument about whether to reopen the Dodd-Frank Act. Democrats and the Obama administration are opposed to significant changes to the regulatory reform law, particularly after big banks successfully added a rollback of a controversial swaps provision to a must-pass spending bill last year. Giving regulators the ability to exempt small banks from a regulation wouldn't necessarily constitute a rewrite of Dodd-Frank — it would simply give the agencies additional flexibility in how they implement the law.

To be sure, observers said there would be issues that need to be worked out. Chief among them is the exact asset size of the cut-off. Bair is proposing \$10 billion and tying it to an index going forward. Camden Fine, the president of the Independent Community Bankers of America, said he likes the proposal, but would like to see a higher threshold.

"As a framework for discussion, it is a concept that ICBA could support," Fine said. "While we fully support indexing, we believe starting at \$10 billion is probably too low. It would need to be a higher asset cut-off than that to begin with."

A debate over the proper cut-off could be a problem, particularly for Democrats worried about big banks taking advantage of any relief provision.

"You end up in a debate on the asset size. Why is \$10 billion the right number? Why isn't it \$20 billion or \$25 billion?" said Brian Gardner, an analyst with Keefe, Bruyette & Woods. "It's intriguing, but it's something that has to be thought through both policy-wise and politically."

Moreover, some raised questions about how far the exception should be extended. For example, would regulators like the Consumer Financial Protection Bureau have the right to exempt institutions from consumer protection rules? Small banks are currently seeking an exemption from the CFPB's "qualified mortgage" rule for loans that are held in portfolio.

"There might be whole swaths of regulation like consumer protection that would be left out of" any exemption powers, said Calabria. "It could end up being very narrow."

Still, the CFPB has significant powers now to carve out small banks from new regulations, such as its mortgage underwriting and servicing standards.

Bair sees the proposal as giving regulators general exemptive authority; she does not envision that small institutions would be exempt from everything as a result. She sees it as similar to powers the Securities and Exchange Commission already has under the law to exempt any person, company or type of company from provisions of certain registration laws, provided that doing so is "necessary or appropriate in the public interest." The bank regulators would have similar authority, but could only apply it to smaller banks.

Other observers raised questions about whether the regulators would act even if they were given this power.

"I'm skeptical that the banking regulators would sign on to it and use it," said Gardner.

But Bair, who chaired the FDIC from 2006 to 2011, said she believes the agencies would act if allowed to by Congress.

"I think they would" use this power, said Bair. "Having Congress sanction their ability for a simpler, less complex regime would be a positive thing."

Overall, she said regulators recognize that community banks are being taxed by regulatory burden and are sympathetic to helping them out.

"Community banks do have a legitimate beef on a lot of this," she said. "Their compliance costs have gone up. It's a shrinking sector. You don't want that. You need to have viable tiny banks, even those less than \$100 million of assets."