One tough regulator's idea for easing rules for banks

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One of the toughest financial regulators in the government has put forward a proposal to give banks relief from strict new regulations and would bridge the difference between Wall Street and its harshest critics.

Federal Deposit Insurance Corporation Vice Chairman Thomas Hoenig has outlined a plan that would give banks broad exemptions from new rules if they met a few simple but demanding conditions, including that they stay away from the kinds of complex contracts that played a role in the financial crisis.

Hoenig has frequently been a roadblock to Wall Street's ambitions and a hero to outside critics of the banking industry. In recent years, he pushed the banks to reorganize to avoid failure and stood with Sen. Elizabeth Warren, D-Mass., against regulatory legislation.

At a conference last weekend held by the Federal Reserve of Kansas, of which he was president prior to joining the FDIC in 2012, Hoenig said he is concerned about the paperwork and rules placed on banks, even if he is more worried about another financial crisis.

"What we're trying to do is address the issues around regulatory burden — and not just community banks, but regional banks as well," Hoenig said in an interview on Bloomberg.

Relief for community banks and regional banks has been a top focus of the industry throughout 2015, as new rules from the 2010 Dodd-Frank reform law and the Basel committee on international rules come into effect.

Lawmakers have sought to provide relief for banks based on size, including through legislation sponsored by Senate Banking Committee Chairman Richard Shelby, R-Ala.,

"We welcome as much regulator attention to the need for regulatory relief as we can get," said Wayne Abernathy, an executive vice president at the American Bankers Association. "The fact that he speaks for regulatory relief and puts some ideas on the table keeps momentum going."

His comments, however, could give a boost to the efforts by Republicans to advance some kind of reform package this year, Abernathy said.

Currently, banks face levels of regulatory oversight that kick in at different sizes. Dodd-Frank classifies any bank with more than $50 billion in assets as a big bank, in the same category as Wall Street behemoths such as JPMorgan Chase. Shelby's bill would lift that cutoff to $500 billion, and other lawmakers have suggested raising it to other levels.

Instead of specifying a size cutoff, Hoenig instead proposes four conditions for relief. Eligible banks would have to have no trading assets or liabilities. They could have no derivatives contracts other than ones used to hedge against interest rate shifts or facilitate foreign exchanges for customers. The total value of their derivatives couldn't exceed $3 billion. Lastly, they would have to have capital of at least 10 percent of their assets.

Those four criteria would define a "traditional banking model" of banks that "engage primarily in lending and in deposit-taking," Hoenig said. It would separate regular banks from the financial conglomerates that make up Wall Street.

If banks met those four conditions, they would be exempt from the Basel capital rules, would face much less oversight and would avoid new mortgage rules for any loans kept on their books.

Hoenig says 90 percent of the 6,400 commercial banks in the U.S. would meet the first three criteria and that two-thirds of them would meet the fourth, which regards capital.

Higher capital levels make banks safer by forcing them to rely less on borrowing, meaning that they can suffer more losses without causing panic among their creditors.

Hoenig suggested that the remaining one-third of banks are within two percentage points of 10 percent capital. Furthermore, he would be willing to approve far more deregulation if they would agree to 20 percent capital levels, a trade-off also recently endorsed by former Federal Reserve Alan Greenspan.

Hoenig first laid out his plan in April, in a speech at a regulatory conference at which Warren also laid out her plan for reforming the financial system. Since then, he has pressed it and refined in it speeches, public appearances and on the Frequently Asked Questions page on the FDIC's website.

While it may not be a deal the industry is willing to take, it's a noteworthy benchmark for future reform efforts, given Hoenig's past role in speaking out against regulatory roll-backs.

The FDIC is typically tougher on banks than the Federal Reserve, and Hoenig has been vocal and aggressive in supporting more stringent regulations.

"He certainly has the credibility to push for small bank relief without being accused of serving" Wall Street, said Mark Calabria, the director of financial regulations studies at the libertarian Cato Institute in Washington.