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Statement by

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Chairman Crapo, Ranking Member Brown, Members of the Committee, thank you for your time and for your invitation to testify today on the Federal Reserve's regulation and supervision of the financial system.

My visit comes 10 years, almost to the day, after the Federal Reserve released the results of its first supervisory stress tests.¹ That exercise was an invention of both urgency and necessity and a tool to move the country's largest financial institutions towards safety and stability. Many innovations from that period are now regular elements of the Federal Reserve's supervisory and regulatory work. These innovations have helped strengthen firms that were damaged by the crisis; given supervisors and the public a clearer view of risks in the financial system; and provided a solid foundation for the nation's economic recovery. Economic and market conditions have afforded us the time and opportunity to refine and improve the post-crisis regulatory framework. Now—when the financial system and economy are in good health—is the time to consolidate the insights we have gained and to better the framework we have built.

Since my last appearance before this Committee, the Federal Reserve has taken several steps to improve the framework, by integrating post-crisis innovations more fully into our supervisory processes; directing our attention and resources to the places and institutions that merit them most; and making our regulatory standards as simple, efficient, and transparent as possible. Today, I will briefly review those steps; outline the Supervision and Regulation Report that accompanies my testimony²; and discuss our other engagement on community, consumer, and financial stability issues, both at home and abroad.

¹ Board of Governors of the Federal Reserve System, "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program," news release, May 7, 2009, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090507a.htm>.

² Board of Governors of the Federal Reserve System, "Supervision and Regulation Report," May 10, 2019, <https://www.federalreserve.gov/publications/files/201905-supervision-and-regulation-report.pdf>.

Regulatory Tailoring and Supervision and Regulation Report

Almost a year ago, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (ERRCPA).³ A cornerstone of this legislation was a directive to the regulatory agencies to tailor oversight of institutions to ensure that our regulations match the character of the firms we regulate, with specific congressional direction for firms between \$100 billion and \$250 billion in total assets. The Board's Supervision and Regulation Report centers on our recent efforts to accomplish this goal.

The core of these efforts are two sets of regulatory proposals, which better align the application of our prudential standards to the risk profiles of different banking firms.⁴ Both sets derive from careful analysis and have benefitted from collaboration with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC). The proposals share a common goal: to focus our energy and attention on both the institutions that pose the greatest risks to financial stability and the activities that are most likely to challenge safety and soundness.

The most recent proposal addresses prudential requirements for the U.S. operations of foreign banks. Like last year's tailoring proposal for domestic institutions, it categorizes firms according to their size, business model, and risk profile. Certain aspects differ from the domestic proposal, however, to reflect the unique characteristics of foreign banks operating in the United States, while preserving faithfulness to the principles of national treatment and

³ EGRRCPA, Pub. L. No. 115-174, 132 Stat. 1296 (2018).

⁴ Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on framework that would more closely match regulations for large banking organizations with their risk profiles," news release, October 31, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181031a.htm>; Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on regulatory framework that would more closely match rules for foreign banks with the risks they pose to U.S. financial system," news release, April 8, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190408a.htm>.

competitive equity. The proposal also asks for input on a number of important issues, and I look forward to reviewing the comments we receive.

These proposals are only one aspect of our efforts to implement last year's legislation. We also have been providing targeted regulatory relief, especially for community banks and other less complex organizations.

- We proposed a new interagency Community Bank Leverage Ratio to give community banking organizations a more straightforward approach to satisfying their capital requirements. State bank supervisors and others have provided thoughtful comments on our work, which we are taking into account.⁵
- We expanded community banking organizations' eligibility for both longer examination cycles and exemptions from holding company capital requirements, and we have proposed more limited regulatory reporting requirements for community banks.⁶
- We provided smaller regional bank holding companies immediate relief from annual holding company assessments and fees, stress testing requirements, and other prudential measures designed for larger institutions.⁷

⁵ Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies propose community bank leverage ratio for qualifying community banking organizations," news release, November 21, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181121c.htm>.

⁶ Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies issue final rules expanding examination cycles for qualifying small banks and U.S. branches and agencies of foreign banks," news release, December 21, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221c.htm>; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies issue proposal to streamline regulatory reporting for qualifying small institutions," news release, November 7, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181107a.htm>; Board of Governors of the Federal Reserve System, "Federal Reserve Board issues interim final rule expanding the applicability of the Board's small bank holding company policy statement," news release, August 28, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180828a.htm>. While holding companies that meet the conditions of the small bank holding company policy statement are excluded from consolidated capital requirements, their depository institutions continue to be subject to minimum capital requirements.

⁷ Board of Governors of the Federal Reserve System, "Statement regarding the impact of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)," July 6, 2018,

- We adjusted our regulatory capital treatment of high-volatility commercial real estate exposures and our regulatory liquidity treatment of municipal securities; exempted community banking organizations from the Volcker Rule; and clarified how collaboration among smaller institutions can help them address their BSA/AML risks.⁸

Many of the regulatory developments implement statutory changes, but they also align with a long-held Federal Reserve policy of directing more resources to the most complex institutions and the most pressing risks. To that end, I am aware that policy changes in Washington can only succeed if they are accompanied by consistent implementation in the field. Deliberate, thoughtful supervision is essential, not only to translate regulatory standards into practice, but also to monitor whether rules are working as intended. I have been visiting supervisory and examination staff across the Federal Reserve System to discuss these issues and to help ensure that the activities of field examiners and policymakers are fully aligned. I plan to continue doing so in the months ahead.

<https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20180706b1.pdf>. The Board also participated in a recent proposal that would modify resolution planning requirements. See Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, “Agencies invite comment on modifications to resolution plan requirements; proposal keeps existing requirements for largest firms and reduces requirements for firms with less risk,” news release, April 16, 2019,

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190416a.htm>.

⁸ Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, “Agencies propose rule regarding the treatment of high volatility commercial real estate,” news release, September 18, 2018,

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180918a.htm>; Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities and Exchange Commission, “Agencies invite comment on a proposal to exclude community banks from the Volcker rule,” news release, December 21, 2018,

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221d.htm>; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Financial Crimes Enforcement Network, National Credit Union Administration, and Office of the Comptroller of the Currency, “Federal agencies issue a joint statement on banks and credit unions sharing resources to improve efficiency and effectiveness of Bank Secrecy Act compliance,” news release, October 3, 2018,

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181003a.htm>; see also Board of Governors of the Federal Reserve System, “Federal Reserve Board issues joint statement encouraging depository institutions to explore innovative approaches to meet BSA/anti-money laundering compliance obligations and to further strengthen the financial system against illicit financial activity,” news release, December 3, 2018,

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181203a.htm>.

The report accompanying my testimony provides more details on these recent regulatory steps, as well as on the overall condition of the banking system. On that front, I am happy to share positive news. Banking institutions of all shapes and sizes continue to show greater loan volumes and fewer delinquencies. Capital levels remain high, and nonperforming loan ratios remain well below their five-year averages. The banking sector often reflects the health of the overall economy, and we continue to monitor emerging risks across the system to ensure institutions of all sizes can maintain their safety and soundness throughout the business cycle.

Regulatory and Supervisory Activities

Supervisory stress testing has become a potent tool for understanding these emerging risks. Its original purpose, however, was much narrower. Even after months of extraordinary public support, the financial system a decade ago remained exceedingly fragile. To relieve strain on the banking system and recapitalize the sector, markets needed credible information, which was then in short supply.⁹ The first crisis-era stress test provided such insight when it was available from few other sources; it was an analysis of last resort, which marked a turning point in the crisis. As conditions changed, the role of stress testing changed as well. Today, the Comprehensive Capital Analysis and Review (CCAR) provides a forward-looking measurement of bank capital, a view of risks across the sector, and a broader understanding of the health of the financial system. As the environment in which we conduct our stress tests evolves, our stress testing processes should evolve commensurately.

In the past half year, the Board took steps to consolidate the role that stress testing plays in our work. Following the directive from the EGRRCPA, we began to transition less complex

⁹ See Ben S. Bernanke, “Stress Testing Banks: What Have We Learned?” (speech at the “Maintaining Financial Stability: Holding a Tiger by the Tail” financial markets conference sponsored by the Federal Reserve Bank of Atlanta, Stone Mountain, GA, April 8, 2013), <https://www.federalreserve.gov/newsevents/speech/bernanke20130408a.htm>.

CCAR firms to an extended testing cycle, reflecting the lower risks they pose relative to their larger, more complex peers.¹⁰ We published new details of our methodology and models, improving public understanding of the program and maintaining the integrity of its results.¹¹ We announced a new stress testing conference, inviting the broad participation, insight, and challenge that are essential for effectiveness.¹² And, while maintaining a rigorous evaluation of capital planning, we committed to addressing qualitative deficiencies at most firms through supervisory ratings and enforcement actions, rather than through a stand-alone qualitative objection.¹³

This core challenge—of keeping our supervisory processes strong, while adapting them to evolving circumstances—is not unique to stress testing. The Board, OCC, and FDIC face a similar task involving the modernization of rules implementing the Community Reinvestment Act (CRA). The value of this statute, which affirms the obligation of banks to meet the credit needs of their communities, is clear. To meet the core objective of the statute, our CRA regulatory framework and supervisory processes must evolve, adjusting to a financial sector being reshaped by technology, consolidation, and other forces. This year, we at the Fed have organized dozens of outreach meetings across the country and hosted a research symposium on

¹⁰ Board of Governors of the Federal Reserve System, “Federal Reserve Board releases scenarios for 2019 Comprehensive Capital Analysis and Review (CCAR) and Dodd-Frank Act stress test exercises,” news release, February 5, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205b.htm>.

¹¹ Board of Governors of the Federal Reserve System, “Federal Reserve Board finalizes set of changes that will increase the transparency of its stress testing program for nation’s largest and most complex banks,” news release, February 5, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205a.htm>; Board of Governors of the Federal Reserve System, “Federal Reserve Board releases document providing additional information on its stress testing program,” news release, March 28, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190328a.htm>.

¹² See Randal K. Quarles, “Inviting Participation: The Public’s Role in Stress Testing’s Next Chapter” (speech at the Council for Economic Education, New York, NY, February 6, 2019), <https://www.federalreserve.gov/newsevents/speech/quarles20190206a.htm>.

¹³ Board of Governors of the Federal Reserve System, “Federal Reserve Board announces it will limit the use of the ‘qualitative objection’ in its Comprehensive Capital Analysis and Review (CCAR) exercise, effective for the 2019 cycle,” news release, March 6, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm>.

this subject, in support of an interagency effort that includes the OCC's issuance of an Advance Notice of Proposed Rulemaking. We intend this effort to ensure that the CRA continues to serve low- and moderate-income communities effectively.¹⁴

Other recent steps support our supervisory and regulatory framework by making it simpler and more transparent. A new ratings system for large institutions aligns more closely with the supervisory feedback they receive, offering greater clarity on our expectations and the consequences of falling short.¹⁵ A new proposal would formalize how the Board determines one company's control of another, clarifying and inviting feedback on an important concept that, among other things, determines the perimeter of the Board's regulatory authority.¹⁶ We continue to monitor other new developments in the industry as well, like the impact of new technology on core banking services, third-party due diligence processes, cyber risk, and vendor risk management.

Effective and efficient regulation requires collaboration, both at home and abroad. We continue to engage with our regulatory counterparts overseas, through standard-setting bodies and the Financial Stability Board (FSB), where I recently began a three-year term as Chair. In establishing the FSB, the G20, led by the United States, recognized that the risks that sparked the financial crisis did not stop at national boundaries. International standards for supervision and regulation help ensure that U.S. firms can play on a level playing field in global competition,

¹⁴ See Jerome H. Powell, "Brief Remarks" (speech at the Just Economy Conference sponsored by the National Community Reinvestment Coalition, Washington, DC, March 11, 2019), <https://www.federalreserve.gov/newsevents/speech/powell20190311a.htm>; Lael Brainard, "Strengthening the Community Reinvestment Act: What Are We Learning?" (speech at "Research Symposium on the Community Reinvestment Act" hosted by the Federal Reserve Bank of Philadelphia, Philadelphia, PA, February 1, 2019), <https://www.federalreserve.gov/newsevents/speech/brainard20190201a.htm>.

¹⁵ Board of Governors of the Federal Reserve System, "Federal Reserve Board finalizes new supervisory rating system for large financial institutions," news release, November 2, 2018, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181102a.htm>.

¹⁶ Board of Governors of the Federal Reserve System, "Federal Reserve Board invites public comment on proposal to simplify and increase the transparency of rules for determining control of a banking organization," news release, April 23, 2019, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190423a.htm>.

foster our own domestic financial stability, and help prevent the fragmentation of financial markets. To secure the full benefits of these standards, the work we undertake with these bodies must also evolve.¹⁷ We must continue to evaluate the post-crisis reforms, address any adverse unintended effects, and identify and manage emerging vulnerabilities.

Conclusion

The strength of our financial system today rests on the insight, patience, and persistence of a decade's work on post-crisis reforms.¹⁸ Those same virtues are essential to preserving that strength in the years to come. We must invite ideas and input into our regulatory and supervisory activities openly, examine them rigorously and objectively, and travel patiently and steadily wherever our analysis leads. A diligent, objective, and independent approach is the only way to remain vigilant towards new risks and ensure that our financial system can continue to address the needs of the U.S. economy. Only by thoughtfully evaluating the reforms we have made, and adjusting our approach when appropriate, can we preserve and improve the efficacy and efficiency of our regulatory framework.

Thank you. I look forward to answering your questions.

¹⁷ See Randal K. Quarles, "Ideas of Order: Charting a Course for the Financial Stability Board" (speech at Bank for International Settlements Special Governors Meeting, Hong Kong, February 10, 2019), <https://www.federalreserve.gov/newsevents/speech/quarles20190210a.htm>.

¹⁸ Board of Governors of the Federal Reserve System, "Federal Reserve, OCC, and FDIC release results of the Supervisory Capital Assessment Program," news release, May 7, 2009, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090507a.htm>.