Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

United States House of Representatives

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Chairman Frank, Ranking Member Bachus, and members of the committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.5 trillion in assets and employ over 2 million men and women.

I appreciate the opportunity to present the banking industry's views on the Obama Administration's financial regulatory reform proposals. They constitute a vast reworking and change of the laws governing financial institutions and others involved in the financial system. It is clear that change is needed, and the ABA supports several aspects of the proposal. We are, however, concerned that the proposal is so vast that the most critical parts may not have received the emphasis they deserve. These are incredibly complex issues, with many dimensions and with the real possibility of unintended consequences. We appreciate the full hearings and consideration in this committee, and we hope the Congress will continue its hard focus on needed reforms.

ABA believes there are three areas that should be the primary focus of reform: the creation of a systemic oversight regulator; the creation of a mechanism for resolving troubled systematically important institutions; and filling gaps in the regulation of the shadow banking system. Indeed, legislation focusing on these three areas would constitute the most significant financial reform package since the 1930s and would address the major causes of the crisis and the weaknesses in responding to the crisis that have been identified. Such a major reform is certain to shape our financial system and our economy for decades to come.

The reforms need to be grounded in a real understanding of what caused the crisis. For that reason, our testimony today will discuss the continuing misunderstanding of the place of traditional banking in the crisis, in resolving the crisis, and in the future. ABA appreciates the fact that the bi-partisan leadership of this committee has often commented that the crisis, in large part, developed outside the traditional, regulated banking sector. The Treasury's plan noted that 94 percent of high cost mortgages were made outside the traditional banking system.

While there are issues within the regulated sector that need to be addressed, we are greatly concerned that the public, the media, and some policy-makers do not understand that traditional banking, with the current regulatory structure, did not cause this crisis. Indeed, traditional banking has continued lending during the crisis to a degree that is remarkable when compared to past recessions; and traditional banking, especially as the excesses of the shadow banking system are reigned in, must be the foundation on which we build our future financial system and economy. Unfortunately, we see a number of ideas being put forth which, while often primarily aimed at the shadow banking system, would in fact pile needless additional regulation on already heavily regulated banks, undermining their ability to support economic growth in their communities.

Appendix 1 to our testimony is the current statement of principles of ABA's Future Regulatory Task Force, and it is these principles that will guide us as we work with Congress, the Administration, and regulators on reform. In the rest of our testimony, we will focus on the following key themes:

- Traditional banks did not create the problems and will be at the heart of the economic recovery.
- Creating an agency to oversee systemic risk represents important reform that ABA strongly supports.
- There must be a mechanism for resolving systemically important institutions and that addresses too-big-to-fail.
- Filling gaps in the regulation of the shadow banking system is critical to preventing any recurrence of the current problems.
- The thrift charter should be preserved.
- In spite of its laudable goals, the proposed Consumer Financial Protection Agency and its extraordinary broad powers raise very significant concerns.

I. Traditional Banks are the Solution, Not the Problem

Traditional banks have a very long history of serving their communities. This is not the first recession faced by banks; many are survivors of the Great Depression and all the ups and downs in between. ***In fact, there are 2,556 other banks – 31 percent of the banking industry – that have been in business for more than a century; 62 percent (5,090) of banks have been in existence for more than half a century.*** These numbers tell a dramatic story about the staying power of community banks and their commitment to the communities they serve.

The focus of traditional banks is on developing and maintaining long-term relationships with customers. They cannot be successful without such a philosophy and without treating customers fairly. This is in sharp contrast to the fly-by-night mortgage operations in the shadow banking world that were only interested in short-term gain with no interest, or stake, in the livelihood of their communities. Most of those non-bank originators are out of business – disappearing as quickly as they appeared when housing values were growing.

Not only did the regulated banks not cause the problem, ***they are the primary solution to the economic problem.*** Banks will continue to be the source of financial strength in their communities by meeting the financial needs of businesses and individuals in both good times and bad. Since banks are a reflection of their communities, banks are suffering in many areas of the country right along with the communities they serve. Banks have made every effort to continue to extend new credit and to renew existing loans. In fact, since the recession began (December 2007) consumer lending has increased by over 8 percent and business lending by over 4 percent. This is in sharp contrast to the pattern in most recessions (see the Table at the right).

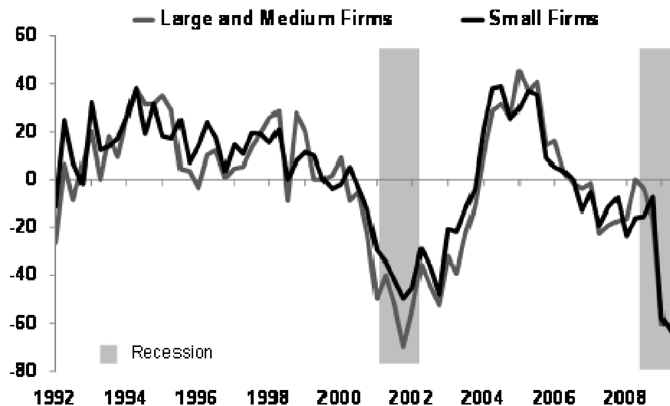
Bank Lending During Recessions

Percent change in loans outstanding during official recession. Inflation adjusted.

	Business Loans	Consumer Loans
Current Recession (Dec 2007 – May 2009)	4.1%	8.6%
Median of Past 6 Recessions	-2.5%	-3.6%

Source: Federal Reserve

Maintaining loan growth has become increasingly difficult as the economy has continued to struggle and job losses mount. As a consequence, the demand for loans from both businesses and individuals has declined sharply (see the Chart at the right). Loan losses have had an impact too, and regulators continue to press banks to be very conservative in underwriting new loans. Thus, we have seen lending volumes begin to fall in the first half of 2009 and expect that to continue in the coming months.



Source: Federal Reserve

Simply put, thousands of banks across the country did not make a single toxic subprime loan; they are strongly capitalized, and are ready to lend; but they cannot do so if misguided policies increase their regulatory costs and provide disincentives to lend. Thus, it is critical that whatever changes are enacted, they serve to improve the ability of banks to continue to meet the needs of their communities. Now is not the time to hamstring the traditional banks that have served their communities for decades and expect to serve them for decades more to come.

II. Creating an agency to oversee systemic risk represents important reform.

The ABA strongly supports the creation of an agency to oversee systemic risk. There appears to be a strong consensus that an oversight mechanism is needed. The subprime crisis demonstrates clearly that our current system is inadequate. In retrospect, this disaster had been building for several years, and there was ample

evidence that something was very wrong, particularly in the very rapid growth of subprime mortgages. Yet the situation was not addressed in any adequate way until it was too late, due in part to a regulatory structure in which each agency was looking within its piece of the puzzle, while no one was explicitly charged with looking at the overall picture. This needs to be changed.

The ABA has purposely not recommended a specific structure for such an agency. We want to be a constructive part of working with Congress and the Administration in designing and enacting this agency. However, let me provide some thoughts on the role and structure.

First, the role should be one of searching for and identifying potential systemic problems and then putting forth solutions. This process is not about regulating specific institutions, which should be left primarily to the prudential regulators. It is about looking at information and trends on the economy, sectors within the economy, and different types of institutions within each sector. Such problematic trends from the recent past would include: the rapid appreciation of home prices far in excess of income growth, proliferation of "affordability" mortgages that ignored long-term ability to repay; excess leverage in some Wall Street firms; the rapid growth and complexity of mortgage backed securities and how they were being rated; and the rapid growth of the credit default swap market.

This agency should be focused and nimble. In fact, involving it in day-to-day regulation could be a distraction. While much of the early focus was on giving this authority directly to the Federal Reserve Board, now most of the focus is on creating a separate council of some type. This would seem to make sense, but it should not be a committee. The council should have its own dedicated staff. It should not be a large bureaucracy, but rather it should have a small staff dedicated to the functions described above. The council should generally not regulate individual institutions and should primarily use information gathered from institutions through their primary regulators, together with broader economic information. However, the systemic agency should have some carefully calibrated backup authority when systemic issues are not being addressed by the primary regulator.

There is currently a debate about the governance of such an agency or council. A board consisting of the major primary regulators, plus Treasury, would seem logical. As to the chair of the agency, there would seem to be three possible choices – Treasury, the Federal Reserve, or an independent person appointed by the President and confirmed by the Senate.

Related to the creation of a systemic regulator is the need to expand certain authorities for the prudential regulator in regulating systemically important institutions. Increased oversight of capital, liquidity, and risk at institutions that could cause systemic problems is appropriate. These enhanced powers, however, need to be balanced with the need to maintain competitive and innovative markets. Nevertheless, there are clear lessons from this crisis that should be addressed through additional regulatory powers.

As the Federal Reserve is given broader powers over some holding companies, ABA urges Congress to take the logical step of moving the regulation of other bank holding companies to the primary prudential regulator. There is no sound reason for the Federal Reserve to continue to regulate and examine the holding companies of community banks that are not members of the Federal Reserve. This is an unnecessary duplicative regulatory cost to banks and a distraction to the Federal Reserve, particularly given its proposed expanded powers.

A systemic oversight regulator could not possibly do its job if it cannot have oversight authority over accounting rulemaking, since accounting policies increasingly and profoundly influence the degree and pace of economic dislocations and the basic structure of our financial system. A recent hearing before your Capital Markets Subcommittee clearly demonstrated the disastrous pro-cyclical impact of recent accounting policies. Accounting should be a reflection of economic reality, not a driver. Thus, a new system for the oversight of accounting rules – one that considers the real-world effects – needs to be created in recognition of the critical importance of accounting rules to systemic risk and economic activity.

We have testified to this point on several occasions before this committee over the last year. Our voice has been joined by more and more people who are calling for changes. Even the Financial Accounting Standards Board (FASB) acknowledged that "the financial crisis has revealed a number of significant deficiencies and points of stress in current accounting standards."[1] ABA strongly advocates that the Congress follow the general recommendations of the Group of 30 report, chaired by Paul Volcker, the G-20 report, and the Administration's financial regulatory reform proposal relating to accounting policy.[2] The Group of 30, for example, suggests that accounting standards be reviewed:

(1) to develop "more realistic guidelines for dealing with less-liquid instruments and distressed markets";

(2) by "prudential regulators to ensure application in a fashion consistent with safe and sound operation of [financial] institutions"; and

(3) to be more flexible "in regard to the prudential need for regulated institutions to maintain adequate credit-loss reserves."

The Group of Thirty report and the G-20 report, signed by the United States, indicate that there needs to be a role for the financial regulators in the oversight of accounting policy. Otherwise accounting policy can undermine efforts to avoid or remedy systemic meltdowns, as mark-to-market accounting has recently done. Accounting policy-makers were able to largely ignore express concerns of financial regulators about the potential

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[1] Financial Accounting Foundation 2008 *Annual Report.*

[2] See in particular the U.S. Treasury Department's *Financial Regulatory Reform – A New Foundation: Rebuilding Financial Supervision and Regulation*, June 200; the G30's *Financial Reform – A Framework for Financial Stability*, January 15, 2009, the G20's *Declaration on Strengthening the Financial System,* London, April 2, 2009, and the Financial Stability Forum's *Report of the Financial Stability Forum on Addressing Procyclicality in the Financial System*, April 2, 2009.

negative impact of policies on reserving and on mark-to-market. The logical way to implement the recommendations of these reports would be to give the new systemic oversight agency an explicit role in the oversight of accounting policy.

The oversight board created by H.R. 1349, introduced by Representatives Perlmutter and Lucas, would be in a position to accomplish the above recommendations. ABA strongly supported this bill in our previous testimony. It would provide, in general, that the FASB report to a group of regulators – including the SEC – rather than solely to the SEC. H.R. 1349 was introduced before the three reports cited above, and those reports clearly align with the overall intent of that bill. H.R. 1349 also predates specific proposals for creating a systemic oversight agency. As the systemic oversight agency is developed, Congress could consider making that agency the appropriate body to which the FASB reports under the approach of H.R. 1349.

III. There must be a mechanism for resolving systemically important institutions and addressing too-big-to-fail.

We have a well-developed and successful mechanism for resolving bank failures, and that system continues to work during these difficult times. Of course, there is no mechanism for the resolution of systemically important non-bank firms. Our regulatory bodies should never again be in the position of making up a solution on the fly to a Bear Stearns or AIG, or of not being able to resolve a Lehman Brothers. The inability to deal with those situations in a predetermined way greatly exacerbated the crisis. It points to the extreme need to create a resolution mechanism for such firms.

The importance of this issue goes well beyond the ability to resolve such firms in the future, however. The lack of clarity about such resolutions creates both uncertainty and presumptions in the marketplace that very much impact the structure and fairness of the financial system today. The structure and protocols for systemic risk resolutions enacted for the future will determine in many respects the structure and fairness of the financial system of the future.

A critical issue in this regard is too-big-to-fail. Whatever is done on the systemic regulator and on a resolution system will set the parameters of too-big-to-fail. In an ideal world, no institution would be too-big-to-fail, and that is ABA's goal; but we all know how difficult that is to accomplish, particularly with the events of the last few months. We agree with Chairman Bernanke's statement: "Improved resolution procedures…would help reduce the too-big-to-fail problem by narrowing the range of circumstances that might be expected to prompt government action.…"[3] This too-big-to-fail concept has profound moral hazard implications and competitive effects that are very important to address.

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[3] Ben Bernanke, speech to the Council on Foreign Relations, Washington, D.C., March 10, 2009.

We are concerned that the too-big-to-fail concept is not adequately addressed in the Administration's proposal, which seems very sketchy on the resolution issue. The treatment of systemically important institutions in a resolution should be as specific as feasible so that the market knows what to expect to the maximum degree possible. How are shareholders, bank investors, and other stakeholders to be treated?

The goal should be to eliminate as much as possible moral hazard and the unfairness to all the ***non***-systemically important competitors. While it may be necessary to leave some flexibility in the resolution process, the approach should not be as vague as it appears to be in the Administration's plan. In general, when an institution goes into the resolution process because of its systemic importance, its top management, board, and major stakeholders should be subject to clearly set out rules for accountability, change, and financial loss. No one should want to be considered too-big-to-fail.

We also question the approach of naming too-big-to-fail companies in advance. Certainly the size and/or market importance of some companies – as well as the application of certain targeted regulations, e.g., on capital and liquidity – will provide strong evidence of which firms are likely to be considered systemically important; but some "constructive ambiguity" may be called for in this regard.

In addition to being more specific about the rules, the structure of the resolution agency needs to be more concrete. Several months ago, the idea surfaced to basically hand this role to the FDIC, based on the fact that it already exists and has a good track record. ABA strongly objected to this idea and continues to do so.

First and foremost, putting the FDIC in charge of such resolutions would greatly undermine public confidence in the FDIC insurance for bank deposits. This confidence is critical, and it is the reason we have seen no significant runs on banks since the 1930s. The importance of this public confidence should not be underestimated, nor should its existence be taken for granted: witness the lines in front of the British bank Northern Rock at the beginning of this crisis. Yet our own research and polling shows that, while consumers trust FDIC insurance, their understanding of how it works is not all that deep. Headlines saying that "FDIC in charge of failed XYZ non-bank" would greatly undermine that trust. Just imagine if the FDIC were trying to address the AIG situation for the past six months. We urge Congress not to do anything that would confuse consumers or undermine confidence in the FDIC.

Our second concern, frankly, is that the banking industry has supported the FDIC with tens of billions of dollars in premiums. ***In fact, the industry will pay around $17 billion in 2009 alone*** (and perhaps more if another special assessment is needed). During these most difficult of times, the industry is committed to paying for all FDIC insurance costs. Thousands of banks have paid premiums since the FDIC was first created. We are concerned that our premiums will be used to pay for the infrastructure of the resolution mechanism, and furthermore, if our fund is strong and a major non-bank fails, there will be a strong temptation to unfairly raid the bank FDIC fund to pay for it.

Nevertheless, we recognize there can be an important role for the FDIC in this resolution process. In addition, within the bank resolution process itself, the FDIC does appear to be handicapped by the inability to address the holding company of the failed bank, which may be very much linked to the bank. ABA would support a carefully structured approach to permit the FDIC to address holding company issues when a bank fails.

Moreover, the FDIC does have expertise and an existing structure that can be helpful in resolving non-banks. ABA would support tapping that expertise, but only in a manner that protects the public's perception of, and confidence in, the FDIC and that fully walls off the FDIC insurance fund. Merely making the non-bank resolution authority a separate part of, or subsidiary of, the FDIC would not be enough. The resolution agency should be entirely separate from the FDIC and have attributes that make it clear that the "Systemic Resolution Agency" is its own agency, with its own funding, while it does use FDIC expertise.

Additional issues that need to be resolved include how decisions are made and by whom with respect to: which entities are sent to the resolution agency; when they are sent; and how critical decisions during the resolution are made. We also are very concerned about the Administration's proposal to pay for resolutions of non-banks. The proposal targets assessments on total liabilities of all bank holding companies, "other than liabilities that are assessed to fund other federal or state insurance schemes." We would like to see a fuller discussion of just what that means and the rationale for it. We see no reason why a community bank holding company should be tapped to pay for systemic risk resolutions, particularly of non-banks, especially while other financial institutions are not, apparently, to pay anything.

IV. Filling gaps in the regulation of the shadow banking system is critical to preventing any recurrence of the current problems.

A major cause of our current problems is the regulatory gaps that allowed some entities to completely escape effective regulation. It is now apparent to everyone that a critical gap occurred with respect to the lack of regulation of independent mortgage brokers. Questions are also being raised with respect to credit derivatives, hedge funds, and others.

Given the causes of the current crisis, there has been a logical move to begin applying more bank-like regulation to the less-regulated and un-regulated parts of the financial system. For example, when certain securities firms were granted access to the discount window, they were quickly subjected to bank-like leverage and capital requirements. Moreover, as regulatory change points more toward the banking model, so too has the marketplace. The biggest example, of course, is the movement of Goldman Sachs and Morgan Stanley to Federal Reserve holding company regulation.

Consumer confidence in the financial sector as a whole suffers when non-bank actors offer bank-like services while operating under substandard guidelines for safety and soundness. Thus, the fundamental principle for closing the gaps in regulation is that similar activities should be subject to similar regulation and capital requirements. For example, capital requirements should be universally and consistently applied to all institutions offering bank-like products and services. Credit default swaps and other products that could pose potential systemic risk should be subject to supervision and oversight that increase transparency, without unduly limiting innovation and the operation of markets.

As these gaps are being addressed, Congress should be careful not to impose new, unnecessary regulations on the traditional banking sector, which was not the source of the crisis and continues to provide credit. Thousands of banks of all sizes, in communities across the country, are scared to death that their already-crushing regulatory burdens will be increased dramatically by regulations aimed primarily at their less-regulated or unregulated competitors. Even worse is the very real concern that the new regulations will be lightly applied to ***non***-banks while they will be rigorously applied – down to the last comma – to banks. As you contemplate major changes in regulation – and change is needed – ABA would urge you to ask this simple question: how will this change impact those thousands of banks that make the loans needed to get our economy moving again?

V. The thrift charter should be preserved.

ABA strongly supports maintaining the federal thrift charter. We believe there is a very solid case for keeping such thrift charters and their holding companies, which include stock federal savings associations, mutual federal savings associations, savings and loan holding companies and mutual holding companies.[4] Typically, these are smaller banks that have very strong ties to their communities. In fact, the median size of a mutual thrift is $100 million and the median size of a stock thrift is $250 million. These charters reflect a business model that has worked in good times and bad. It is based upon a housing expertise that permits the regulated housing lenders to make safe and sound loans. Thrift institutions have taken the lead in re-establishing economic growth – whether it is the thrifts that are lending to help rebuild New Orleans, or those that are leading community development plans from coast to coast to put Americans back to work.

Mr. Chairman, ABA appreciates your public statements in support of maintaining the thrift charter. There are 800 plus thrift institutions and another 125 mutual holding companies representing 10 percent of the banking industry. They are truly the traditional banks that are lending, that have been lending and will continue to lend. Forcing these institutions to change their charter and business plan is disruptive, costly and wholly

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[4] State-chartered savings associations would be affected by any law eliminating the federal thrift charter as the powers and requirements of these state charters are governed under the Home Owners Loan Act. Also, state-chartered savings banks would be affected because a number of savings banks have elected to form thrift holding companies. For instance, about half of all mutual holding companies with state-chartered savings bank subsidiaries are approved and regulated by the Office of Thrift Supervision.

unnecessary. Having these institutions shift their focus deprives our nation of a continuity of lending at a time when we need more credit availability, not less.

Thrift institutions have served our country through many economic cycles. ***In fact, nearly one out of three thrifts have been in existence for over 100 years; one out of two have been in existence over 50 years***. Federal mutual charters have been a part of the mutual savings bank experience that dates back almost two hundred years. These institutions are survivors of all of our nation's downturns. They made responsible residential mortgage loans through thick and thin and have slowly, steadily, and safely facilitated responsible and growing homeownership in this country – all of which has helped strengthen our economy and the communities served by these institutions.

Eliminating the thrift charter is bad public policy for many reasons:

- ***It hurts legitimate thrift institutions that had nothing to do with the problems.*** "Toxic" subprime mortgages were not and are not the business of traditional thrifts. Most thrifts never made a so-called "toxic" subprime loan; rather, they have maintained solid underwriting standards – particularly because many hold the mortgage loans they make in their own portfolio. They have to write these loans with an eye toward how they will perform over the entire life of the loan.

  Abolishing the thrift charter would exact retribution on institutions that had nothing to do with the crisis we are in. It makes no sense to hurt institutions that made the good loans and are now in a position to help homeowners abused by the shadow banking system. It is inappropriate to continue to use the thrift charter as a symbol of the current housing and financial problems.

- ***It does nothing to address the underlying problem.*** As has been documented time and time again, the problem in subprime lending originated outside the banking industry. As noted above, most of those non-bank originators are out of business. These largely unregulated firms were able to make the toxic subprime loans ***without*** a banking or thrift charter. Simply put, the charter did not create the problems and eliminating it provides no cure.

- ***It targets thrifts in particular, when thrift financial performance is no different from other charters.*** While there have been some high-profile failures of federal thrift institutions over the last 18 months, there have also been high-profile failures of other financial firms. The failures have been a result of bad underwriting and bad business decisions – factors totally unconnected with the charter or business model. In fact, the statistical evidence shows that thrifts are no more likely to be unprofitable and no more likely to be on the FDIC's problem bank list. The financial performance of thrifts in this economic downturn is no different from that of other charters. ***Thus, the problems in housing markets are not a consequence of the charter.*** The real culprits responsible for the vast majority of problems in the housing market were institutions that had ***neither*** a bank or a thrift charter.

It is completely inappropriate to indict the entire thrift industry for the actions of a few players – particularly since most of the abuses arose outside the banking industry. In a competitive marketplace, failures are expected. It makes no sense to punish those firms that made the right decisions, exercised prudent standards, and treated customers well.

- ***It serves only to confuse customers of thrifts and undermine confidence in banking.*** One of the great frustrations of many in the banking industry is that they are being painted with the same brush as those institutions that were at the heart of the problems. If the thrift charter were to be eliminated, the public is likely to infer from it that these institutions are weak or were responsible for the problems – ***none of which is true***. Perpetuating this horrible misperception is not only unfair to these healthy thrifts, but it can potentially be very destabilizing.

- ***It ignores the significant contributions that the thrift industry has made to homeownership.*** Expanding homeownership has long been an important public policy goal in the United States. While the subprime crisis has raised important questions about the appropriate homeownership rate, we should not forget the significant benefits that our country has enjoyed over the decades due to our nation's encouragement of homeownership.

  Thrifts are experts in responsible real estate lending. Eliminating the thrift charter, with dedicated expertise that understands the economic benefits to communities, would be backing away from decades of supporting homeowners, builders, developers, and suppliers. It would signal to these institutions that focusing on residential mortgage lending is no longer valued and neither is housing expertise developed over decades. The nation needs stability. That's what the thrift charter offers – continuity of lending at a time when our nation needs more lending, not less.

- ***It creates costs that are unnecessary, taking resources away from potential homebuyers.*** Eliminating the charter will result in very significant costs to these thrift institutions. Inevitably, there will be operational expenses associated with any change in charter. Management time will be diverted in a major way from running the institution to all the complex legal and business issues involved in the change. More troubling is that the clear intent of this provision is to force thrift institutions to focus less on residential housing loans and more on other types of lending – otherwise why would there be any reason to change the charter at all? Thus, former-thrifts would have to change their entire business model, extending loans in areas where they may not have significant experience on staff. Success requires the business model and lending expertise to match. Eliminating the thrift charter would result in less money flowing from prudent housing lenders, and with it, higher costs of any mortgage lending and less credit available.

- ***It will hurt perspective homeowners that benefit from the lending expertise of thrift institutions.*** Supporting homeownership has long been a public policy goal in the United States. The very existence of financial institutions that focus on residential home loans has enabled more and more people to become homeowners. There is no question that imprudent underwriting by some lenders – primarily non-banks – created problems for many individuals. But in spite of these problems, the long history of thrift institutions in facilitating homeownership should not be ignored. Changing the focus and eliminating specialized lenders will likely mean that some deserving individuals will not enjoy the opportunities of being a homeowner.

- ***It forecloses options for mutual savings associations and credit unions that choose a banking charter.*** Mutuals are tax-paying cooperatives that are subject to the full gambit of federal banking laws and one of the few options available to credit unions that wish to remain mutual while seeking new ways to serve their members and communities. Mutuals take the longer view and can invest for good of the community in longer-term projects, which is why more than 40 percent of mutuals institutions have existed for more than a century and more than 95 percent for over 50 years.

  Mutual thrifts' capital is very strong – typically about 30 percent greater than industry averages. However, because of their structure, capital accumulation is typically through retained earnings. The existence of the mutual holding company option, however, provides more tools to raise capital without abandoning the community control represented by mutual ownership. This helps keep the mutual bank local and not the next acquisition target for an out-of-town stock institution.

Eliminating the Office of Thrift Supervision (OTS) does nothing to resolve the problems that occurred either. The recent financial crisis revealed problems associated with all of the regulators, and, most importantly, gaps in the financial regulatory structure. Singling out OTS will not fix the gaps that existed in the shadow banking system. The better solution is to fill the gaps in regulation: bring the non-bank mortgage lenders up to the standards of banks and thrifts.

Moreover, efficiencies that some have suggested would be achieved by eliminating OTS are likely illusory. It is proposed to force charter conversions on thrifts, not eliminate them. As a result, the same number of banking institutions would remain operating, albeit some with charters not of their choice or liking. As a result, the regulatory system would need to commit at least the same level for supervisory resources, and perhaps an even greater amount as the former thrifts adjust to charters not well suited to their businesses.

VI. The proposed Consumer Financial Protection Agency and its extraordinary broad powers raise very significant concerns.

Since the ABA testified before this committee about its deep concerns with the proposed CFPA on June 24, we will not repeat all our concerns in this testimony. However, in general, ABA opposes the proposal on two grounds. First, on the basic structure, ABA does not believe the regulation of a company and its products can be separated without causing severe problems and conflicts. Second, the unprecedented broad powers given to the new agency raise a number of important questions Congress should consider.

Since our June testimony, legislative language on the CFPA has been submitted by Treasury. That language confirms our deep concerns. Based on that language, we want to emphasize two points that were discussed briefly during the June hearing. One point is how the agency is to be funded. The proposed language is very vague, but basically says it will be funded by fees on financial accounts and products. Given the broad mandate of this agency, it will need a significant budget. If it does not have a large budget, it will confirm our concern that it will not effectively enforce its rules on non-banks, which will be grossly unfair to banks. If it does have a large budget, these fees on financial institutions will be considerable. Also, it is very unclear how those fees are to be collected from the wide assortment of entities subject to CFPA jurisdiction – from banks, to credit unions, to mortgage brokers, to appraisers, and to many, many more.

A second point raised at the earlier hearing is the very broad powers of the agency. All current financial consumer protection laws, carefully crafted by Congress, are rendered largely moot—mere floors. The CFPA can do almost anything it wants to go beyond those laws, as well as into new areas, to regulate the terms of products, the way in which they are offered, and even the compensation for offering them. It is one thing to identify holes in existing regulation and close them; it is another, in effect, to take out the entire body of laws, developed over decades, on which consumer finance is based and, in effect, replace it with a broad general regulatory authority – an authority that will create great uncertainty for years to come, reduce consumer choices, and undermine the availability of credit.

ABA appreciates the fact that the Chairman removed the direct transfer of CRA authority to the new agency when he introduced his bill last week. As we noted in our previous testimony, CRA lending has not led to material safety and soundness concerns, and bank CRA lending has been prudent and safe for consumers. However, there is often a debate between a bank and its regulator about individual CRA programs and loans as to the right balance between outreach and sound lending. That debate is now resolved in a discussion with one regulator. If CRA was moved to the consumer regulator, there would be a constant conflict between the two regulators, with banks caught in the middle, as to whether certain loans and their terms were appropriate, and CRA lending would be more subject to second guessing.

Conclusion

The Obama Administration's financial regulatory reform proposals constitutes a vast reworking and change of the laws governing financial institutions and others involved in the financial system – so vast that the most critical parts may not have received the emphasis they deserve. These are incredibly complex issues, with many dimensions and with the real possibility of unintended consequences. The ABA believes that reforms need to be grounded in a real understanding of what caused the crisis. It is critical to understand that traditional banks, operating under the current regulatory structure, did not cause this crisis. Indeed, traditional banks have continued to lend and will be at the heart of the economic recovery.

ABA believes there are three areas that should be the primary focus of reform: the creation of a systemic oversight regulator; the creation of a mechanism for resolving troubled systematically important institutions; and filling gaps in the regulation of the non-bank or what some have called the shadow banking system. Such legislation would address the major causes of the crisis and the weaknesses in dealing with the crisis once it had begun. Focusing on these three key areas would constitute major reform which is almost certain to shape our financial system and our economy for decades to come.

We appreciate the full hearings and consideration in this committee, and we stand ready to work with you to enact workable reform legislation.

Appendix

Principles for Future Regulatory Reform

ABA Future Regulatory Reform Task Force

Preamble

Banks have been and continue to be the primary institutions for saving, lending, and financing economic growth in our nation's communities. Banks are also the leading players in the payments system and the only institutions that can be found participating in every stage of the payments system. Held to high standards of financial strength and integrity of operations, banks are well-poised to be engines of economic recovery and continued economic growth and development thereafter.

Our customers include people and families from all walks of life and involve businesses of all sizes. The innovation and the diversity of the banking industry enable us to meet changing customer needs and interests. Through these efforts in recent decades more people have gained access to a wider array of banking products—and at lower costs—than ever before, and better than anywhere else in the world.

We support a regulatory program that fosters a climate in which we can build on these accomplishments and continue our progress in providing more and better services to more people and businesses at lower costs.

1) Reforms should focus on solving the problem.

a) The central objective of reform efforts should be facilitating the ability of all financial institutions to meet the needs of their customers. This is best done by focusing on the following:

   i) Health of financial institutions, including safety and soundness;

   ii) Consumer protection coupled with consumer education and consumer choices;

   iii) Full and fair competition; and

   iv) Flexibility to innovate and respond to customer interests, needs and changes to the marketplace, including technology changes.

b) A business model combining activities that are financial in nature has served as a solution to, not a part of, the problem. The stability of our nation's financial services is enhanced by a diversified revenue mix, access to a stable base of insured deposits, access to the payment system, availability of a broad range of financial products, and a recognition that the market for most financial products and services is national in scope and connected to global financial markets.

c) Congress should be careful not to impose new regulations on the banking sector, which did not cause the crisis and continues to provide credit; rather it should remove unnecessary regulations that impede sound lending and efficient operations.

d) FDIC-insured financial institutions are not the problem. The regulatory supervision process has been demonstrated to be the most effective approach in minimizing systemic and individual institution safety and soundness risk. Congress should focus on the inadequately and ineffectively regulated sectors of the financial services industry that caused the crisis.

e) Reforms of the payments system must recognize that merchants have been the source of the largest number of abuses and lost customer information. All parts of the payments system must be responsible for its integrity.

2) The current system of bank regulators has many advantages. These advantages should be preserved as the system is enhanced to address systemic risk and non-bank resolutions.

a) Regulatory restructuring should incorporate systemic checks and balances among equals and a federalist system that respects the **jurisdictions** of state and federal powers. These are essential elements of American law and governance.

b) We support the roles of the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Federal Reserve, the Office of Thrift Supervision (OTS) and the state banking commissioners with regard to their diverse responsibilities and charters within the U.S. banking system.

c) Bank regulators should focus on bank supervision. They should not be in the business of running banks or managing bank assets and liabilities.

d) An independent central bank is essential.

i) The Federal Reserve's primary focus should be the conduct of monetary policy.

ii) An important part of the conduct of monetary policy is the integrity of the payments system, including the efficiency, security, and reliability of the payments system. The Federal Reserve should have the duty to set the standards for the integrity of the payments system.

e) The FDIC should remain focused on its primary mission of assuring the safety of insured deposits.

i) The FDIC plays a crucial role in maintaining the stability and public confidence in the nation's financial system by insuring deposits, and in conducting activities directly related to that mission, including examination and supervision of financial institutions as well as managing receiverships and assets of failed banking institutions so as to minimize the costs to FDIC resources.

f) There is a need for a regulator with explicit systemic risk responsibility.

i) Systemic risk oversight should utilize existing regulatory structures to the maximum extent possible and involve a limited number of large market participants, both bank and non-bank.

ii) The primary responsibility of the systemic risk regulator should be to protect the economy from major shocks. The systemic risk regulator should pursue this objective by gathering information, monitoring exposures throughout the system and taking action in coordination with other domestic and international supervisors to reduce the risk of shocks to the economy.

iii) The systemic risk regulator should work with supervisors to avoid pro-cyclical reactions and directives in the supervisory process.

g) There should not be a new consumer regulator for financial institutions. Safety and soundness implications, financial risk, consumer protection, and other relevant issues need to be considered together by the regulator of each institution.

h) A system for handling the resolution of non-bank financial firms should be developed to replace the current ad hoc approach, such as was used with Bear Sterns and Lehman Brothers.

i) To coordinate anti-money laundering oversight and compliance, a Bank Secrecy Act "gatekeeper," independent from law enforcement and with a nexus to the payments system, should be incorporated into the financial regulatory structure.

3) The dual banking system is essential to promote an efficient and competitive banking sector.

a. The role of the dual banking system as incubator for advancements in products and services, such as NOW and checking accounts, is vital to the continued evolution of the U.S. banking sector.

b. Close coordination between federal bank regulators and state banking commissioners within Federal Financial Institutions Examination Council (FFIEC) as well as during joint bank examinations is an essential and dynamic element of the dual banking system.

4) Charter choice and choice of ownership structure are essential to a dynamic, innovative banking sector that responds to changing consumer needs, customer preferences, and economic conditions.

a) Choice of charter and form of ownership should be fully protected.

b) ABA strongly opposes charter consolidation. Unlike the flexibility and business options available under charter choice, a consolidated universal charter would be unlikely to serve evolving customer needs or encourage market innovation.

c) Diversity of ownership, including S corporations, limited liability corporations, mutual ownership, and other forms of privately held and publicly traded banks, should be strengthened.

d) Diversity of business models is a distinctive feature of American banking that should be fostered.

i) Full and fair competition within a robust banking sector requires a diversity of participants of all sizes and business models with comparable banking powers and appropriate oversight.

ii) Community banks, development banks, and niche-focused financial institutions are vital components of the financial services sector.

iii) A housing-focused banking system based on time-tested underwriting practices and disciplined borrower qualification is essential to sustained homeownership and community development.

e) An optional federal insurance charter should be created.

5) **Similar activities should be subject to similar regulation and capital requirements. These regulations and requirements should minimize pro-cyclical effects.**

a) Consumer confidence in the financial sector as a whole suffers when non-bank actors offer bank-like services while operating under substandard guidelines for safety and soundness.

b) Credit unions that act like banks should be required to convert to a bank charter.

c) Capital requirements should be universally and consistently applied to all institutions offering bank-like products and services.

d) Credit default swaps and other products that pose potential systemic risk should be subject to supervision and oversight that increase transparency, without unduly limiting innovation and the operation of markets.

e) Where possible, regulations should avoid adding burdens during times of stress. Thus, for instance, deposit insurance premium rates need to reflect a balance between the need to strengthen the fund and the need of banks to have funds available to meet the credit needs of their communities in the midst of an economic downturn.

6) **A new system for the establishment of accounting rules—that makes standard setters accountable and considers the real-world effects of accounting rules—needs to be created in recognition of the critical importance of accounting rules to systemic risk and economic activity.**

   a) The setting of accounting standards needs to be strengthened and expanded to include oversight from the regulators responsible for systemic risk.

   b) Accounting should be a reflection of economic reality, not a driver.

   c) Accounting rules, such as loan-loss reserves and fair value accounting, should minimize pro-cyclical effects that reinforce booms and busts.

   d) Clearer guidance is urgently needed on the use of judgment and alternative methods, such as estimating discounted cash flows when determining fair value in cases where asset markets are not functioning.

7) **Recent government actions have clearly demonstrated a tendency to treat certain financial institutions as if they were too big or too complex to fail. Such a policy can have serious competitive consequences for the banking industry as a whole. Without accepting the inevitability of such a policy, clear policy actions must be taken to address and ameliorate negative consequences of such a policy, including efforts to strengthen the competitive position of all banks.**

   a) Financial regulators should develop a program to watch for, monitor, and respond effectively to market developments relating to perceptions of institutions being too big or too complex to fail—particularly in times of financial stress.

   b) Specific authorities and programs must be developed that allow for the orderly transition of the operations of any systemically significant financial institution.