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Federal Deposit Insurance Corporation
550 17th Street, NW, Washington, DC 20429-9990 Legal Division

July 15, 2014

RE: FDIC FOIA Request Log No. 14-0463

This is in response to your June 19, 2014 Freedom of Information Act ("FOIA") request for "a copy of each response to a Question for the Record (QFR) provided to Congress by the FDIC," for the time period since January 1, 2009. You provided the following instructions:

> If this request will require extensive searches, please contact me so we can discuss narrowing of the request. If this will produce voluminous records, please limit the request to records created since January 1, 2012.

As is discussed further below, and in accord with your instructions, we interpreted this request as seeking records for the period since January 1, 2012.

The FDIC's records search has been completed, and responsive information has been located. With the exception of signatures, the responsive information is being disclosed. I have enclosed a copy of the information that is being disclosed (202 pages).[1]

The redacted information is exempt from disclosure under FOIA Exemption 6, 5 U.S.C. § 552 (b)(6). Exemption 6 permits the withholding of personnel and medical files and similar files the disclosure of which would constitute a clearly unwarranted invasion of personal privacy.

Because some of the requested information has been withheld, this letter constitutes formal notification that your request has been denied in part. You have the right to appeal the denial to the FDIC's General Counsel within 30 business days following receipt of this letter. If you decide to appeal, please submit your appeal in writing to the General Counsel. Your appeal should be addressed to the FOIA/PA Group, Legal Division, FDIC, 550 17th Street, NW, Washington, D.C. 20429. Please refer to the log number and include any additional information that you would like the General Counsel to consider.

For fee purposes, your request was categorized as having been made for other than commercial use. Therefore, you are entitled to two hours of free search time and to one hundred pages of free duplication, but would be responsible for the payment of all other search and duplication

[1] The FDIC has confirmed that some of the responsive records also were processed in response to one or more earlier FOIA requests that you earlier submitted (*e.g.*, FDIC FOIA Request Log No. 13-0450. It is not reasonably practicable for the FDIC to search all of your earlier request files to identify all duplicates; further, doing so would have increased the billable costs. Therefore, all otherwise responsive records were processed in this request whether or not processed in response to a request that you earlier submitted to the FDIC.

costs, up to the amount of your fee agreement, whether or not any responsive information was located and if located, whether or not any responsive information was released or withheld. Costs under $10.00 are not assessed.[2]

You agreed to pay costs to only $30.00. In responding to your request for the period since January 1, 2012, the FDIC expended two hours of search time by professional staff, and 202 pages were duplicated. Since you are entitled to two hours of free search time and to one hundred pages of free duplication, the billable costs already are $20.40 (*i.e*., 102 pages duplicated @ $0.20 per page). I have enclosed an Invoice for the balance due.

Since you are not be entitled to any more free search or duplication, any additional search time by professional staff would be assessed @ $83.00 per hour, and any additional duplication would be assessed @ $0.20 per page. Based on experience, the unused portion of your fee agreement (*i.e.*, $30.00 - $20.40 = $9.60), is not sufficient to process your request for the period January 2009 – December 2011.

The processing of this request now has been completed.

If you have any questions about this response, you may reach me by telephone at: 703-562-2039.

Sincerely,

/signed/

Jerry Sussman, Senior FOIA Specialist
FOIA/Privacy Act Group

Enclosures:

1. Responsive records (202 pages); and
2. Invoice ($20.40 balance due).

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[2] The FDIC's FOIA regulations and FOIA Fee Schedule are available on the FDIC's website, www.fdic.gov, under the Home page link to the "Freedom of Information Act ("FOIA") Service Center, http://www.fdic.gov/about/freedom/index.html

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

June 3, 2014

Honorable Jeb Hensarling
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Chairman Hensarling:

Thank you for the opportunity to testify before the Committee at the February 5, 2014 hearing "The Impact of the Volcker Rule on Job Creators, Part II."

Enclosed are my responses to the follow up questions to complete the hearing record.

If you have additional comments, please feel free to contact me at (202) 898-3888, or Eric Spitler, Director, Office of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg

Enclosure

Response to questions from the Honorable Scott Garrett
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Process (All)

Given that the rule was out for proposal for two years and given the broad impact that it is going to have on our U.S. financial markets, why was the new rule not put out for additional public comment? If it had been, would the problems associated with TruPS and CLOs been caught and been addressed instead of causing all of the problems those provisions have?

A1: The agencies' review of the public comments was extremely thorough. At the completion of the review, the agencies determined that is was appropriate to proceed to with a final rule. The final rule made a number of important changes from the proposed rule in response to the comments received.

With respect to CDOs backed by bank-issued trust preferred securities, it is fair to say that everyone missed the immediacy of the accounting issues associated with the potential treatment of TruPS CDOs as a covered fund. Not only did the agencies not identify this accounting issue, the industry and other commenters missed the immediacy of this issue as well. For example, throughout the extended notice and comment period, none of the over 18,000 comment letters raised this issue.

Once the TruPS CDO issue was identified, the agencies worked closely together and, with input from the industry, developed an effective and timely response to the majority of the bankers' concerns.

Similarly, with respect to the CLO issues raised by industry, the agencies have carefully reviewed comments and data received from the banking and financial services industry and other interested parties. Based on discussions with and data provided by industry representatives, the agencies understand that CLOs issued after the Volcker Rule became final contain only loans in the underlying exposures, making them compliant with the loan securitization exemption. In addition, the agencies understand that a large number of legacy CLOs consist solely of loans and would be compliant with the Volcker Rule. The agencies worked closely together to evaluate the implications for banks holding CLOs containing non-loan assets and facing reinvestment period restrictions that would not comply with the Volcker Rule. After this extensive interagency review process, on April 7, 2014, the Federal Reserve released a statement announcing the intent to grant two one-year extensions to the Volcker Rule conformance period for certain CLOs, which the agencies believe should address the majority of legacy CLOs that do not comply with the Volcker Rule. The agencies believe that the extended conformance period should allow many of the non-compliant legacy CLOs to mature or otherwise "roll off," such as through investor calls, and should offer investment managers time to potentially adjust the underlying assets to loans, thereby bringing the CLOs into conformance.

Q2: Econ Analysis (OCC, FRB, FDIC)

The Riegle Community Development and Regulatory Improvement Act ('Riegle Act,' 12 U.S.C. §4802(a)), requires all "Federal banking agencies including the OCC, the Fed, and the FDIC, to: "[i]n determining the effective date and administrative compliance requirements for new regulations that impose additional reporting, disclosure, or other requirements on insured depository institutions, each Federal banking agency shall consider, consistent with the principles of safety and soundness and the public interest - (1) any administrative burdens that such regulations would place on depository institutions, including small depository institutions and customers of depository institutions; and (2) the benefits of such regulations."

Why did you not follow the law when promulgating this rule? How can you expect others you are regulating to follow the law when you yourself don't follow it?

A2: In implementing the Volcker Rule, the agencies considered the administrative burdens placed on depository institutions. The compliance program adopted in the final rule reflects this concern. Under the final rule, banking entities that do not engage in proprietary trading or covered fund activities will not be required to develop a compliance program unless they become engaged in such activities. Final Rule §__.20(f)(1). In addition, the agencies have eased the administrative burden placed on small banks that modestly engage in these activities. Specifically, banking entities with less than $10 billion in total consolidated assets may incorporate compliance with the Volcker Rule into their existing compliance programs. Final Rule § __.20(f)(2). The final rule requires only the largest banks (those with $50 billion or more in total consolidated assets) to observe the enhanced minimum standards for compliance programs under Appendix B of the final rule. Final Rule §__.20(c). Furthermore, the reporting and recordkeeping requirements for covered trading activities under Appendix A of the final rule are inapplicable to the vast majority of banking entities; only those banking entities with the most significant trading activities, delineated at $10 billion or more in total trading assets and liabilities, must comply with these additional requirements. Final Rule §__.20(d).

Q3&4 addressed to SEC/CFTC

Q5: Foreign Sovereign Exemption + CLOs (FRB, OCC, FDIC)

The Volcker preamble states that the regulators are using safety and soundness authority to exempt certain foreign sovereign debt. Some of this foreign sovereign debt can be extremely risky, as we have seen with Spain, Italy, Portugal and Greece. One could easily make the case that actually means you are using safety and soundness authority to make banks less safe and less sound.

On the other hand, when it comes to addressing the problems in the CLO market, the preamble also states that you could use your safety and soundness authority to address the

concerns surrounding those assets but you have refused to do so. If banks are forced to fire-sale their legacy CLO holdings, this could drive down asset prices, hurt the market, and actually make banks less safe and less sound. In fact, some banks have stated specifically that if is not addressed, the new rules will force them to collapse.

Why are you using your safety and soundness powers to allow banks to prop trade risky sovereign debt which will make banks less safe and less sound? Shouldn't you be using your safety and soundness authorities to help save little community banks like First Federal instead of putting them out of business solely based on overly aggressive interpretation of the statute, one never intended by Congress?

A5: The final rule does not contain a blanket exemption for proprietary trading in foreign debt. Rather, the final rule only permits the U.S. operations of foreign banking entities to engage in proprietary trading in the foreign sovereign debt of the foreign sovereign under whose laws the banking entity is organized, and any multinational central bank of which the foreign sovereign is a member so long as the proprietary trading is not made by an insured depository institution. Similar to the exemption for proprietary trading in U.S. government obligations, the permitted trading activity in the U.S. by the eligible U.S. operations of a foreign banking entity would extend to obligations of political subdivisions of the foreign banking entity's home country. This exemption allows these U.S. operations of foreign banking entities to continue to support the smooth functioning of markets in foreign sovereign obligations in the same manner as U.S. banking entities are permitted to support the smooth functioning of markets in U.S. government and agency obligations. At the same time, the risk of these trading activities is largely determined by the foreign sovereign that charters the foreign bank.

The final rule also permits a foreign bank or foreign broker-dealer regulated as a securities dealer and controlled by a U.S. banking entity to engage in proprietary trading in the obligations of the foreign sovereign under whose laws the foreign entity is organized, including obligations of an agency or political subdivision of that foreign sovereign. This limited exemption is necessary to allow U.S. banking organizations to continue to own and acquire foreign banking organizations and broker-dealers without requiring those foreign banking organizations and broker-dealers to discontinue proprietary trading in the sovereign debt of the foreign banking entity's home country. This limited exemption will allow U.S. banking entities to continue to be affiliated with and operate foreign banking entities and benefit from international diversification and participation in global financial markets. However, the agencies intend to monitor activity of banking entities under this exemption to ensure that U.S. banking entities are not seeking to evade the restrictions of the Volcker Rule by using an affiliated foreign bank or broker-dealer to engage in proprietary trading in foreign sovereign debt on behalf of or for the benefit of other parts of the U.S. banking entity.

The agencies have reviewed the extent of bank investments in CLOs. Data contained in the Call Report and Y9-C forms for asset-backed securities or structured financial products secured by corporate and similar loans indicate that U.S. banking entities hold between approximately $84

billion and $105 billion in CLO investments.[1] Of this amount, between approximately 94 and 96 percent are held by banking entities with total assets of $50 billion or more. Only 21 institutions with assets less than $10 billion held CLOs. Holdings of CLOs by domestic banking entities represent between approximately 28 to 35 percent of the $300 billion market for U.S. CLOs, with these holdings skewed toward the senior tranches.[2] These aggregate holdings reflect an unrealized net gain. Unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. Up to 52 domestic insured depository institutions (all charters) reported holdings of CLOs in their held-to-maturity, AFS and trading portfolios.[3]

Q6: New Market Entrants (All)

There has been repeated discussion that other new entrants will step in to make up any potential disruption in market liquidity that the implementation of the Volcker rule may create. Can you specifically name some of these new entrants? Who are they? Have they stepped in? Are they only stepping in already liquid markets?

A6: The agencies believe the Volcker Rule will not impair banks' ability to make markets. Certainly in recent years, the health and vibrancy of the corporate bond market has not been in question. For example, based on data from the Federal Reserve *Flow of Funds*, the net funds raised in credit markets by U.S. nonfinancial corporations reached a record $399 billion in 2013, following a strong showing of $244 billion in 2012. Moreover, since passage of the Dodd-Frank Act, several organizations have announced plans to increase liquidity and decrease costs to customers in the corporate bond market or other markets. For example, one prominent organization announced an in-house trading network in 2012, to help reduce the costs of bond trading for its clients. Nonetheless, the agencies plan to monitor the liquidity of the corporate bond market to ensure that liquidity is not impaired by the Volcker Rule.

Q7: Enforcement (All)

Thank you for your testimony regarding the formation of an interagency working group. Can you tell us more about the structure of the group - for instance will there be a chairman? What is the timeline for identifying members of the group? What will the process be for stakeholders to communicate with the interagency group?

A7: The agencies are committed to continued coordination efforts to clarify any additional issues or concerns that may be raised with respect to the implementation of the Volcker Rule. To

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[1] This information is based on data compiled as of December 31, 2013, by the federal banking agencies, which undertook a review and analysis of CLO holdings of banking entities that are subject to filing Call Report or Y-9C data, including insured depository institutions, bank holding companies and certain savings and loan holdings companies.

[2] OCC supervised institutions hold the majority (95 percent) of this CLO exposure. These positions are concentrated in the largest institutions and are held mainly in the AFS portfolio.

[3] Based on Call Report data as of December 31, 2013.

better effectuate coordination and help ensure a consistent application of the final rule, the agencies have established an interagency Volcker Rule implementation working group consisting of senior-level managers and subject matter experts. The working group is made up of several senior staff from each of the agencies. The members of the group were identified in January and have been meeting regularly Leadership of the group is a joint responsibility of the agencies. Each agency is ultimately responsible for its own enforcement of the Volcker Rule and, as such, banking organizations should raise issues and concerns directly to their primary federal regulator.

Response to questions from the Honorable Peter T. King
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

The U.S. is the only nation that has prohibited its banks from engaging in proprietary trading. By contrast, not only have other countries refused to adopt such a ban on "proprietary trading," they have encouraged their banks to follow a universal banking model in which there is no effort to segregate proprietary trading from commercial banking.

Q1: If the U.S. remains the only developed country to implement a restriction on proprietary trading, will U.S. corporations—faced with higher borrowing costs—be placed at a competitive disadvantage against their foreign counterparts?

A1: The United States is not unique in the concern about the possible impact of proprietary trading on financial institutions. The European Commission, in addition to individual countries such as Britain, France, and Germany, is taking steps to prohibit, limit, restrict, or isolate the risks associated with proprietary trading by traditional banking entities. For example, the European Commission's recent proposal on structural reform of the EU banking sector would prohibit the biggest and most complex banks in Europe from engaging in proprietary trading and from holding investments in hedge funds and other funds that engage in proprietary trading. In addition, the proposed reform would separate other non-proprietary trading activities from traditional banking activities if the non-proprietary trading activities were significant. While these proposals may differ in some respects and are still being developed, they represent important attempts by foreign jurisdiction to prevent the risks of proprietary trading from threatening the banking entity, traditional banking activities, the public safety net, and the broader financial system.

In addition, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches rely primarily on separating deposit-taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions and requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany.

Even if other countries do not move forward with implementing restrictions on proprietary trading, we do not believe that U.S. corporations will be placed at a competitive disadvantage. The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. As such, U.S. banks should remain competitive in all core banking and investment banking businesses.

Q2: What effect will the U.S.'s decision to adopt the Volcker Rule have on the ability of U.S. financial institutions to compete against their foreign counterparts?

A2: As noted above, the Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. The Volcker Rule also generally does not prevent banks from making long-term strategic investments. The Volcker Rule was designed to prevent banks from taking speculative, proprietary trading bets and making significant investments in high-risk hedge funds and private equity funds, while relying on the public safety net. As a result, the U.S. will have a safer banking system that is less vulnerable to market disruptions, and more competitive internationally.

Q3: Will the U.S. financial system be made more robust and safer by the adoption of the Volcker Rule? Or will the U.S. financial system find itself left behind as those institutions and business that can look elsewhere for liquidity leave the U.S.?

A3: As discussed above, we believe the system will be made more robust and safer.

Q4: What effect will this weakening of the U.S. capital markets have on the U.S. economy?

A4: As discussed above, we believe the Volcker Rule will result in a safer banking system that is less vulnerable to market disruptions. This will be a source of competitive strength to our markets and economy.

Response to questions from the Honorable Dennis Ross
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: How do you expect to notify market participants about how they are supposed to report Volcker Rule data and to whom the data will be sent?

a. **When will you notify market participants? Will that notification be done jointly?**
b. **Who on this panel has been tasked with ensuring that there will be a consistent reporting format across all of the regulators?**
c. **Will one agency serve as the central repository for all reporting?**
d. **Here is my concern, we are already hearing that at least two of you cannot agree about one of the metrics – the inventory turnover and customer facing trade ratio. The SEC has said that data should be recorded as of July 1, while the OCC has said this data should be recorded as of April 1. Who is correct? Assuming you believe that you are both correct, then whose interpretation controls for an entity that is subject to examination by both of your agencies?**

A1: The reporting of metrics only applies to the largest, most-complex banking organizations – those whose gross sum of trading assets and liabilities exceed $10 billion. This threshold is not set based on total assets, but on the size of the banking organization's trading activities. As such, we only expect approximately 24 of the very largest banking organizations operating in the United States will be required to report metrics, and of those, about half will report beginning in 2014.

The agencies have discussed the metric reporting dates as part of the interagency Volcker Rule implementation working group and are in agreement. Each of the agencies intends to communicate through supervisory channels to their regulated entities regarding the reporting requirements for 2014. In general, a banking entity with trading assets and liabilities of at least $50 billion must begin to measure and record the required metrics on a daily basis starting July 1, 2014. Such a banking entity must report its daily metrics recorded during the month of July to its primary Federal regulator by September 2, 2014. The agencies will continue to work together to help ensure consistent requirements for the calculation of metrics.

Q2. I've been contacted by a businessman in my district who operates a registered investment advisory firm. They wish to offer a municipal bond fund to community banks that is comprised of investment grade bank qualified municipal bonds. The fund would be exempt from registration under the Investment Company Act of 1940 and would be completely unleveraged and without any debt. Under the Volker Rule, they are unable to offer this fund unless it is registered—but registration would require over $200,000 in compliance and registration costs. That cost would ultimately be passed on to the consumer—thereby negating benefit of the fund.

a. **Was this an intended consequence of the Volcker Rule?**
b. **If not, what would be the appropriate action moving forward to solve this issue?**

A2: The rule does not prohibit banks from investing in all unregistered funds. It only prohibits them from investing in unregistered funds that must rely on exemptions in 3(c)(1) or 3(c)(7). Funds that are able to rely on other exemptions from registration under the Investment Company Act of 1940 are not necessarily prohibited by the Volcker Rule. FDIC staff would be glad to discuss particular concerns and have set up an email address (capitalmarkets@fdic.gov) to handle questions such as these. We encourage your constituents to contact the FDIC at this email address.

Response to questions from the Honorable Stephen Fincher
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Addressed to SEC

Q2: The Volcker Rule will take effect around the same time as higher capital standards mandated under Basel III. What will be the combined impact of the Volcker Rule and Basel III on interest rates for corporate borrowers?

How liquid is the market for the corporate debt of companies that make up the Dow Jones Industrial Average or the Russell 2000 index? How will the Volcker Rule affect the liquidity for these bonds?

A2: The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. The Rule was designed to prevent banks from engaging in speculative, proprietary trading and making significant investments in high-risk hedge funds and private equity funds. The Volcker Rule generally does not prevent banks from making long-term strategic investments.

In addition, Basel III does not raise the capital requirements for traditional corporate borrowings. Basel III does require banks to maintain higher levels of high quality capital, but the vast majority of banks already meet these standards.

As a result, we do not expect the combined impact of the Volcker Rule and Basel III to have a material impact on interest rates for corporate borrowers. Further, we do not expect the Volcker Rule to adversely affect the liquidity of the market for corporate bonds. Notwithstanding these expectations, the agencies have agreed to monitor the liquidity of the corporate bond market as the Volcker Rule is implemented.

Response to questions from the Honorable Randy Hultgren
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Addressed to SEC

Q2: Addressed to SEC/CFTC

Q3: Addressed to FRB/OCC

Q4: The California Public Employees Retirement System (CALPERS) has said that for "the Volcker Rule to work effectively, it should be implemented globally. Without multilateral agreements with regulators in other countries, establishing Volcker type restrictions on U.S. financial market-making institutions may put them a competitive disadvantage." Has CALPERS raised a legitimate concern? What can be done to address this concern?

A4: The United States is not unique in the concern about the possible impact of proprietary trading on financial institutions. The European Commission, in addition to individual countries such as Britain, France, and Germany, is already taking steps to prohibit, limit, restrict, or isolate the risks associated with proprietary trading by traditional banking entities. For example, the European Commission's recent proposal on structural reform of the EU banking sector would ban the biggest and most complex banks in Europe from engaging in proprietary trading and from holding investments in hedge funds and other funds that engage in proprietary trading. In addition, the proposed reform would separate other non-proprietary trading activities from traditional banking activities if the non-proprietary trading activities were significant. While these proposals may differ in some respects and are still being developed, they represent important attempts by foreign jurisdiction to prevent the risks of proprietary trading from threatening the banking entity, traditional banking activities, the public safety net, and the broader financial system.

In addition, reforms dealing with the trading activities of banking firms have been recommended by the Vickers Commission in the United Kingdom and the Liikanen Group in the European Union. These approaches primarily rely on separating deposit-taking entities within large banking organizations from affiliates that engage in securities trading and securitization functions and requiring separate capitalization for the deposit-taking entities. This approach has been incorporated into implementing legislation enacted in the United Kingdom, France, and Germany.

Even if other countries do not move forward with implementing restrictions on proprietary trading, we do not believe that U.S. corporations will be placed at a competitive disadvantage. The Volcker Rule was not intended to prevent banks from engaging in traditional banking activities, including underwriting, market-making, and risk-mitigating hedging functions. As such, U.S. banks should remain competitive in all core banking and investment banking businesses.

Response to questions from the Honorable Robert Hurt
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: There are five agencies represented here today, but we cannot forget to include the self-regulatory agencies, such as FINRA and the National Futures Association (NFA), who have to build out an examination program for this massive new mandate for the entities they regulate. How engaged were the SROs in the rulemaking process?

Q2: What issues or problems were raised by SROs during the rulemaking process and how were they addressed?

Q3: What feedback have you received from FINRA and NFA about the final rule? Please provide specific details on challenges raised and how they have been addressed.

Q4: Have you provided FINRA and NFA any guidance on how to implement the Volcker Rule?

Q5: What happens when FINRA and the NFA flag something that they believe may not be compliant – do they contact all of you?

A1 - 5: The FINRA and NFA are self-regulatory agencies for entities whose primary federal regulators generally are the SEC and CFTC, respectively. As such, the FDIC has not interacted with the FINRA or NFA as part of the rulemaking process.

Response to questions from the Honorable Blaine Luetkemeyer
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: How many insured depository institutions nationwide still have investment banks and/or proprietary trading entities inside the depository institution, and therefore associated with the Deposit Insurance Fund?

A1: Only a small number of banking organizations have trading activities of any kind. For example, in the third quarter of 2013, only 261 banks out of almost 7,000 (or 3.7 percent) reported any amount of trading activity. Fewer than twelve U.S. banking organizations with insured depository institutions have trading assets and liabilities that exceed $10 billion, the metrics reporting threshold under the final Volcker Rule.

Q2: Of the top twenty financial institutions, by asset size, in the United States, how many have divested themselves of proprietary trading entities? How many maintain proprietary trading entities for the purposes of market making, as defined under the Volcker Rule?

A2: According to public reports, five financial institutions have explicitly stated that they have divested themselves of stand-alone proprietary trading desks and other entities that were established for the sole purpose of proprietary trading. However, it is possible that proprietary trading could still continue as part of financial institutions' broader trading activities. When metrics reporting is fully phased-in, we expect less than 12 banking organizations (excluding foreign banking entities) to report metrics. We believe these organizations conduct the vast majority of market-making undertaken by banking organizations.

Q3: On what date did each financial institution divest itself of its proprietary trading entity?

A3: The five largest financial institutions divested of their stand-alone proprietary trading desk and other stand-along proprietary trading operations between the end of 2010 and 2013. The following are relevant excerpts from their public financial statements:

JPMorgan 2012 10-K	"The Firm ceased some prohibited proprietary trading activities during 2010 and has since exited substantially all such activities." (page 2)
Goldman Sachs 2013 3Q 10-Q	"[W]e evaluated the prohibition on 'proprietary trading' and determined that businesses that engage in 'bright line' proprietary trading are most likely to be prohibited. In 2011 and 2010, we liquidated substantially all of our Principal Strategies and Global Macro Proprietary trading positions." (page 139)

Bank of America 2012 10-K (see also Merrill Lynch 2012 10-K)	"Although Merrill Lynch exited its stand-alone proprietary trading business as of June 30, 2011 in anticipation of the Volcker Rule and to further our initiative to optimize our balance sheet, the ultimate impact of the Volcker Rule on us remains uncertain." (page 13)
Citigroup 2012 10-K	"The wind down of Citi's equity proprietary trading was completed at the end of 2011." (page 27)
Morgan Stanley 2012 10-K	"[A]s of January 1, 2013, the Company has divested control of its remaining in-house proprietary quantitative trading unit, Process-Driven Trading ("PDT")... The Company has also previously exited other standalone proprietary trading businesses (defined as those businesses dedicated solely to investing the Company's capital), and the Company is continuing to liquidate legacy positions related to those businesses." (page 9)

Response to questions from the Honorable Keith Ellison
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Access to banking for people with Islamic names

Reportedly, there have been recent cases of people or organizations with Islamic names suddenly having their bank accounts closed. For example, on May 30, 2013, JPMorgan Chase notified an Arabic language business in Michigan that its account would be closed within 10 business days. JPMorgan Chase offered no explanation as to why the account was being terminated. In addition, TCF Bank announced that it would close bank accounts for about two dozen graduate students at the University of Minnesota who were citizens of Iran. Ultimately, TCF only closed three accounts, after receiving a clarifying decision that graduate students are exempt from Iran sanctions legislation.

Please let us know what is being done to ensure that individuals and organizations with Islamic names are not unduly denied financial services.

A1: The FDIC is committed to broad inclusion and fair access to participation in the banking sector. To that end, our compliance examinations routinely seek to identify discriminatory lending and unfair and deceptive practices as a matter of course. Additionally, staff in our Division of Depositor and Consumer Protection engages in outreach activities, as well as complaint investigations and reviews to identify, address, and prevent discrimination and consumer harm.

We have not received any complaints similar to those you mention. However, we would have supervisory concerns with practices that discourage potential customers based on their names. Such practices could raise concerns under the Equal Credit Opportunity Act (ECOA), and Section 5 of the Federal Trade Commission Act, which prohibits unfair and deceptive acts and practices.

While banks are required to know their customers, there is nothing in the Bank Secrecy Act that allows a bank to choose or decline a banking relationship with an entity or person, based solely on the origin of the entity's or person's name. The decision to open, close, or decline a particular account or relationship is typically made by a bank without involvement by a bank regulatory agency, consistent with applicable law and regulations, including the Bank Secrecy Act. This decision is based on the bank's particular business objectives, an evaluation of the risks associated with offering particular products or services, and its capacity and systems to effectively manage those risks.

As part of customer due diligence, U.S. banks are expected to verify their customer's identity and to assess the risks associated with that customer. U.S. banks are expected to obtain information at account opening sufficient to develop an understanding of normal and expected activity for the customer's occupation or business operations. Additionally, U.S. banks are expected to monitor customer account activity to ensure the activity is commensurate with the

stated purpose of the account. If there is indication of a potential change in the customer's risk profile (e.g., expected account activity, change in employment or business operations), bank management should reassess the customer risk rating and follow established bank policies and procedures.

Q2: Accepting U.S. government documents in other languages

According to a report released by GAO last week (Troubled Asset Relief Program, More Efforts Needed on Fair Lending Controls and Access for Non-English Speakers in Housing Programs, February 2014, http://www.gao.gov/assets/670/660712.pdf), in a 2013 national survey of housing counselors conducted by the National Housing Resource Center, and a similar survey conducted by the California Reinvestment Coalition, nearly half of the housing counselors who responded said their limited English proficient (LEP) clients who were receiving mortgage servicing assistance "never" received translated foreclosure-related documents, while more than 60 percent said their clients were "never" or only "sometimes" able to speak to their servicer in their native language or through a translator provided by the servicer (p.27-28). What steps is your agency taking to ensure that the institutions it regulates are adequately servicing their LEP customers?

A2: We are committed to broad, safe, and fair access to financial services from FDIC-supervised institutions. Economic inclusion is one of our priorities, and we continue to look for ways to improve access consistent with safe and sound operations.

Generally, our examinations have focused on linguistic issues on the front-end of transactions to ensure that consumers are provided with meaningful advertisements and disclosures before consummation. Specifically, examiners might be concerned if a bank advertises in a foreign language, but provides key disclosures only in English. Likewise, servicing or loan modifications offered only in English to a population to whom products were sold in a foreign language would raise red flags for examiners.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

May 7, 2014

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for the opportunity to testify before the Committee at the February 6, 2014 hearing "Oversight of Financial Stability and Data Security."

Enclosed are my responses to the follow up questions to complete the hearing record.

If you have additional comments, please feel free to contact me at (202) 898-3888, or Eric Spitler, Director, Office of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg

Enclosure

Response to questions from the Honorable Mike Crapo
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: When a data breach happens at a merchant level, federal banking regulators generally do not have jurisdiction to investigate and take action. However, collateral consequences of such breaches are that regulated financial institutions are impacted and face reputational and financial setbacks as a result. What are your expectations for the regulated entities when a breach occurs at a third party? What are some of the challenges financial institutions face as a result of the breach? How can those challenges be addressed while minimizing consequences of, and cost for, affected financial institutions?

A1: Responsibility for security of financial institutions' customer information held at third parties is addressed through contractual terms between the two parties. The federal banking agencies developed the *Interagency Guidelines Establishing Information Security Standards* (12 C.F.R. 364, Appendix B et al.) in response to the Gramm-Leach-Bliley Act, Section 501(B). These standards direct all insured financial institutions to require service providers, by contract, to implement appropriate measures to protect against unauthorized access to or use of customer information that could result in substantial harm or inconvenience to any customer.

Each financial institution is expected to manage financial and reputational risk related to the products they offer and ensure that adequate controls are in place to mitigate that risk. Risk management responsibilities related to potential payment card data breaches are addressed through contractual terms and policies among the issuing banks, acquiring banks (banks that sponsor merchants' access to the payment card networks), and card networks (Visa and MasterCard). The contractual terms and policies describe the responsibility of the parties to implement controls, loss liability of the parties, and loss recovery processes. Issuing banks and acquiring banks receive fees for their participation in this partnership, in part, to offset risks. The extent to which fees and loss recovery models adequately cover card re-issuing costs or costs for protecting data at the merchant also is a contractual arrangement.

The card networks have established notification processes to alert the issuing banks of suspected compromised accounts. Issuing banks are responsible for limiting the potential for fraud on any accounts suspected of being compromised once the issuing bank is notified. Conversely, the acquiring banks' merchants may be fined by the card network due to misconduct (such as poor security) to support recovery of fraud losses, in addition to direct responsibility for fraud due to card-not-present (on-line) transactions, or card-present transactions that are not authorized by the issuer. The acquiring bank remains at risk for the merchant's fines and losses to the extent the merchant is unable to meet its responsibilities. The FDIC's role is to ensure the safety and soundness of the issuing banks and acquiring banks, including the ensuring of adequate reserves against losses, appropriate security controls, and protection of customer accounts against unauthorized charges or withdrawals.

A significant challenge that financial institutions face as a result of data breaches is notification to potentially affected customers and the potential for customers to become desensitized by the notices. Given the frequency that data breaches occur and the goal to notify potentially affected customers as soon as possible, customers may discard the notices and fail to follow the instructions provided to protect their credit rating. Financial institutions can address this challenge by providing notices that are written in plain language with clear and direct instructions.

Q2: At the Subcommittee hearing on data security and breach held on February 3, 2014, Members learned that the payment networks have set an October 2015 time frame for moving industry participants to adoption of new, more secure payment technology. Can you discuss how quickly your regulated entities are moving to this technology, and identify some of the obstacles that still exist?

A2: The FDIC does not mandate specific technologies for data security as technology and threats evolve very rapidly. However, the FDIC expects financial institutions to establish an information security program that will adjust to any relevant changes in technology, the sensitivity of its customer information, and internal or external threats to information. The FDIC welcomes the industry initiative to strengthen card security technology through the implementation of the Europay, MasterCard, and Visa (EMV) global standard for card authentication. However, while the new EMV standard improves the card-present aspect of fraud prevention, it does not make it more difficult to steal the card data from merchant databases, nor does it address on-line fraud or fraud at merchants still accepting credit cards with customer data stored in the magnetic stripes (commonly referred to as "mag-stripe") for purchases.

As part of the examination process, the FDIC does not identify which financial institutions will offer the new EMV enhanced cards. However, to encourage EMV chip card issuance and acceptance, the card brands/networks (Visa, MasterCard, Discover, and AMEX) have announced that beginning in October 2015, entities, including financial institutions and merchants, that do not use the new EMV standard will face increased liability for fraud. We agree with their assumption that the potential for increased fraud liability will encourage adoption of the technology.

Q3: In July of 2013, I requested that the Government Accountability Office (GAO) review the SIFI designation process at FSOC for both transparency and clarity, and to examine the criteria used to designate companies as SIFIs. Would you all be willing to support more reliance on measurable metrics in FSOC's designation process?

A3: The current FSOC framework for the designation of nonbank SIFIs addresses the specific statutory considerations set forth in Section 113 of the Dodd Frank Act Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). It combines measurable, quantitative thresholds and metrics with qualitative analysis to address the nature of the unique threats that FSOC seeks to mitigate. Nonbank financial companies engage in a wide

variety of complex activities and possess material differences in operating and financial characteristics. For example, these firms may be holding companies or operating companies, and they may have differing business models, risk profiles, funding sources, capital structures, and interconnections that may make evaluating the systemic risk they pose to the U.S. financial system more difficult using solely quantitative metrics.

In April 2012, after notice and public comment, the FSOC issued interpretative guidance setting forth both quantitative thresholds and qualitative information that the FSOC had determined to be relevant in the designation process in order to provide transparency and clarity to companies, market participants, and the public. The FSOC's interpretative guidance addresses, among other things, the uniform quantitative thresholds that the FSOC uses to identify nonbank financial companies for further evaluation and the six-category framework used to consider whether a nonbank financial company meets either of the statutory standards for a determination, including examples of quantitative metrics for assessing each category. In addition, the interpretative guidance includes a three-stage process for the review of a nonbank financial company, which incorporates quantitative thresholds in the first stage and more qualitative company-specific analyses in the second and third stages.

Generally, as reporting requirements evolve and new information about certain industries and nonbank financial companies become available, the FSOC will be better able to consider whether to establish additional metrics and thresholds.

Q4: Please explain how and why the agencies failed to foresee the accounting issue with the treatment of the Trust Preferred Collateralized Debt Obligations (TruPS CDOs) in the final Volcker Rule. Did the proposed rule include requisite language seeking public comment on TruPS CDOs, as finalized? If so, please provide that language from the proposed rule. If not, please explain why the proposal did not seek that specific information and whether the agencies believe they satisfied the notice-and-comment requirements under the Administrative Procedure Act.

A4: It is fair to say that everyone missed the immediacy of the accounting issues associated with CDOs backed by bank-issued trust preferred securities. As part of developing the final rule, the agencies clearly missed the immediacy; however, the industry and other commenters missed the immediacy of this issue as well. For example, throughout the rather extended notice and comment period, none of the over 18,000 comment letters raised this issue.

An important take-away from this episode is how the agencies responded when the issue was identified. The agencies worked closely together and, with input from the industry, developed an effective and timely response to the majority of the bankers' concerns. Importantly, the agencies were able to do so in a manner that reconciled the broader policy objectives of the Dodd-Frank Act without jeopardizing the robustness of the implementation of the Volcker Rule.

As part of the notice-and-comment process, the agencies sought robust public comment on the proposed Volcker Rule. Included in the notice of proposed rulemaking were several

questions seeking comments on any concerns or challenges to issuers of asset-backed securities and/or securitization vehicles. For example, Question 227 asked whether certain asset classes, including collateralized debt obligations, are more likely to be impacted by the proposed definition of "covered fund." Question 229 asked if there are entities that issue asset-backed securities that should be exempted from the requirements of the proposed rule. Question 231 stated that many issuers of asset-backed securities have features and structures that resemble some of the features of hedge funds and private equity funds, including CDOs, and asked if the proposed definition of "covered fund" were to exempt any entity issuing asset-backed securities, would this allow for interests in hedge funds or private equity funds to be structured as asset-backed securities and circumvent the proposed rule. Commenters did not raise concerns about TruPS CDOs in their responses to the proposed rule.

Q5: What specific efforts are the regulators considering to address the issue with the Collateralized Loan Obligations (CLOs) in the final Volcker rule? In Governor Tarullo's testimony before the House Financial Services Committee, he stated that the CLO issue is "already at the top of the list" for regulators to consider and fix. How many financial institutions are impacted by the final rule's treatment of CLOs?

A5: The agencies are carefully considering all requests that have been received related to CLOs. These requests have ranged from the very narrow – requesting a grandfathering of a well-defined, limited number of CLOs issued before publication of the Volcker Rule – to the very broad – requesting a change to the definition of ownership interest that would potentially allow banks to expand their holdings of other types of securitization positions, such as synthetic CDOs and structured investment vehicles (SIVs), which caused significant financial losses during the crisis.

The agencies' staffs jointly have met with representatives of the Loan Syndication Trade Association, the American Bankers Association, the Structured Finance Industry Group, the Financial Services Roundtable, and the Securities Industry and Financial Markets Association. Based on these discussions with the industry representatives, a review of data provided by market participants, and discussions among the staffs of the agencies, the agencies found:

- Banking entities that hold legacy CLOs are undertaking a review of their particular holdings to evaluate where they fit within the treatment of covered funds under the agencies' implementing regulations. Industry representatives have advised the staffs of the agencies that there is a great amount of variation from deal to deal in the restrictions applicable to investments permitted for CLOs and the rights granted to CLO investors. In addition, staffs of the agencies understand from the industry that many legacy CLOs may not satisfy the exclusion from the definition of covered fund for loan securitizations because they may hold a certain amount of non-conforming assets (such as bonds or other securities).

- New CLO issuances have been comparable in volume to the CLOs issued prior to the adoption of the implementing rules and sponsors have revised their new CLO deals to

conform to the Volcker Rule's exception for loan securitizations. In particular, market participants have represented that new issuances of CLOs in late 2013 and early 2014 after issuance of the final rule are conforming to the final rule.[1]

- Data contained in the Call Report and Y9-C forms for asset-backed securities or structured financial products secured by corporate and similar loans indicate that U.S. banking entities hold between approximately $84 billion and $105 billion in CLO investments.[2] Of this amount, between approximately 94 and 96 percent are held by banking entities with total assets of $50 billion or more. Holdings of CLOs by domestic banking entities represent between approximately 28 to 35 percent of the $300 billion market for U.S. CLOs, with these holdings skewed toward the senior tranches.[3] These aggregate holdings reflect an unrealized net gain. Unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. Up to 52 domestic insured depository institutions (all charters) reported holdings of CLOs in their held-to-maturity, AFS and trading portfolios.[4]

To address the concerns regarding CLOs, the Federal Reserve Board issued a statement that it intends to grant two additional one-year extensions of the conformance period under the Volcker Rule that allow banking entities additional time to conform to the statute ownership interests in and sponsorship of CLOs in place as of December 31, 2013, that do not qualify for the exclusion in the final rule for loan securitizations.[5] The FDIC supports the statement issued by the Federal Reserve Board.

Q6: Since the final Volcker rule was issued in December, the affected entities have recognized two issues with the final rule (TruPS CDOs and CLOs). What other issues with the final Volcker rule are your agencies aware of that may be raised by affected entities? How do you intend to coordinate efforts on clarifying such issues in the future?

A6: In the agencies' release for community banks that accompanied the Final Rule, the agencies noted that a few community banks held TruPS CDOs and CLOs that would be affected by the rule.[6] The TruPS CDO issue was the most pressing because the TruPS CDOs

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[1] According to S&P, the majority of CLOs issued since the final rule have been structured as loan-only securitizations. Year to date, CLO issuance stands at approximately $21 billion, according to Thomson Reuters PLC.

[2] This information is based on data compiled as of December 31, 2013, by the federal banking agencies, which undertook a review and analysis of CLO holdings of banking entities that are subject to filing Call Report or Y-9C data, including insured depository institutions, bank holding companies and certain savings and loan holdings companies.

[3] OCC supervised institutions hold the majority (95 percent) of this CLO exposure. These positions are concentrated in the largest institutions and are held mainly in the AFS portfolio.

[4] Based on Call Report data as of December 31, 2013.

[5] See Board Statement regarding the Treatment of Collateralized Loan Obligations Under Section 13 of the Bank Holding Company Act (April 3, 2014).

[6] http://fdic.gov/regulations/reform/volcker/summary.pdf

had lost so much value that the immediate accounting impact was substantial. The agencies worked together on the TruPS CDO issue and approved the January 14, 2014, Interim Final Rule to address bank investments in certain TruPS CDOs. With respect to the CLO issues raised by industry, the agencies conducted extensive analysis and met with a number of banking and financial services industry groups, as described in more detail in the answer to question 5. As a result of this process, the Federal Reserve recently issued a statement which announced its intent to offer two one-year extensions to the Final Rule conformance period for certain CLOs. The agencies believe that the extension should address the compliance issues for many of the legacy CLOs that do not meet the loan securitization exemption, allowing many of them to mature or be called by investors, and should provide more time for CLO managers to evaluate and possibly change the composition of the underlying assets to bring the CLOs into conformance.

The agencies are committed to continued coordination efforts to clarify any additional issues or concerns that may be raised with respect to the implementation of the Volcker Rule. To better effectuate coordination and help ensure a consistent application of the Final Rule, the agencies have established an interagency Volcker Rule implementation working group consisting of senior-level managers and subject matter experts. This working group has been meeting weekly to discuss coordination matters as well as issues such as those related to technical interpretations and specific activities, like those raised on TruPS CDOs and CLOs.

Q7: How do you plan to coordinate with other agencies regarding enforcement matters and the final Volcker rule, given that your agencies have varied jurisdictions?

A7: Each agency is ultimately responsible for its own enforcement of the Volcker Rule; however, as noted previously, the agencies are committed to continued coordination efforts to help ensure a consistent application of the rule. As noted above, the agencies have established a Volcker Rule implementation working group to facilitate interagency coordination on a wide variety of issues.

Q8: On January 10, 2014, the Federal Reserve and the FDIC made available the public portions of resolution plans for 116 institutions that submitted plans for the first time in December 2013, the latest group to file resolution plans with the agencies. These living wills are based on a premise that when a financial firm is near the brink, there will be a marketplace where buyers for assets and operations are available, but that may not be the case as was evident with Lehman's 2008 collapse when no one wanted to touch what was perceived as Lehman's "toxic assets." What specifically gives you confidence that these living wills will work in the first place and that there will be willing buyers for the troubled firm's assets?

A8: The 116 plans represent the latest set of institutions to file their initial plans. The FDIC and the Federal Reserve currently are in the process of reviewing these resolution plans (or "living wills"), as we have done for the plans filed earlier in 2013 and in 2012. Under the standards provided in section 165(d) of the Dodd-Frank Act, certain firms, known as "covered

companies," are required to submit plans for their rapid and orderly resolution under the Bankruptcy Code in the event of their material financial distress or failure. The resolution plan rule jointly promulgated by the FDIC and the Federal Reserve, which implements the statutory requirement of section 165(d), directs covered companies to include, among other items, a discussion of key assumptions and supporting analysis underlying the covered company's resolution plan and the processes the company employs to assess the feasibility of any sales, restructurings, or divestures contemplated in the resolution plan. Therefore, to the extent that a firm presents a resolution plan in which certain assets of a troubled firm will be sold as a key part of its resolution strategy, the firm would need to provide supporting analysis. In addition, the resolution plans may present options for resolution other than asset sales that are consistent with bankruptcy (such as restructurings, for example). If the FDIC and the Federal Reserve jointly determine that a resolution plan would not facilitate an orderly resolution of the covered company under the Bankruptcy Code, the FDIC and the Federal Reserve will notify the filer of the aspects of the plan that were jointly determined to be deficient. The filer must re-submit within 90 days (or other specified timeframe) a revised plan that addresses the deficiencies.

Response to questions from the Honorable Mark Kirk
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: FSOC has been in existence for more than 3 years. Since that time, 3 companies have been deemed systemically significant and a second round of companies appear to be under consideration. Despite the numerous calls from Congress, a number of industry and consumer groups and even the GAO for the FSOC to provide greater transparency about the process used for designation, (including the metrics OFR should measure in their analysis), the criteria followed, as well as the implications and process to be followed after a firm has been designated a SIFI. Can you provide greater details on why more transparency has not been achieved and how the FSOC plans to improve these issues?

A1: The FSOC has worked to ensure that the designation of firms follows processes that provide transparency and certainty to companies, market participants, and members of the public and incorporates the specific statutory considerations of Section 113 of the Dodd-Frank Act governing designation of nonbank companies. At the same time, the FSOC is mindful of nonbank financial companies' concerns that sensitive firm-specific non-public information be protected from disclosure. To provide transparency and clarity regarding its designation process, the FSOC issued, after notice and public comment, a final rule and interpretative guidance in April 2012. The public comment process helped to ensure that key issues were fully considered and transparent to the public.

The interpretative guidance details the FSOC's analytical framework for designation of nonbank financial companies and includes quantitative metrics. The analysis performed on each individual company considered for designation requires analysis of non-public information, which may be provided by the company's regulators and by the company itself in response to requests from the FSOC. The company is provided with the basis for the FSOC's proposed determination and may request a hearing to contest the determination. In addition, the FSOC has adopted policies to ensure that the processes are as transparent as practicable to the public. After a final designation, a document explaining the basis for its determination to designate a company and minutes of the designation votes are posted to the FSOC's public website.

Following a firm's designation as a SIFI, the implications and process to be followed are set out in the Dodd-Frank Act. The Federal Reserve, as primary federal regulator, develops the prudential standards that will be applicable to nonbank designated firms, under section 165 of the Dodd-Frank Act, for its ongoing supervision of these firms. In addition, the FDIC and the Federal Reserve Board meet with the newly designated firms to provide guidance for the preparation of their resolution plans under Title I of the Dodd-Frank Act.

The FDIC, as a member of the FSOC, is committed to the issue of transparency and takes these concerns as well as suggestions for improvement very seriously. As reporting requirements evolve and new information about certain industries and nonbank financial

companies become available, the FSOC will be better able to consider whether changes to assure transparency of the designation process are needed.

Q2: I, along with a number of other Republicans, introduced legislation to fix an unintended consequence on collateralized debt obligations (CDOs). In their January 13th interim final rule, regulators crafted a rule that largely mirrored what my bill sought to do; provide relief to a majority of community banks. While we appreciate the agencies' efforts on this issue, one issue that we included in our legislation that the regulators did not address was collateralized loan obligations (CLOs). The CLO market provides about $300 billion in financing to U.S. companies and U.S. banks currently hold between $70 and $80 billion of senior notes issued by existing CLOs and foreign banks subject to the Volcker Rule hold about another $60 billion. Because the final rules implementing the Volcker Rule improperly treat these debt securities as "ownership interests", the banks holding these notes will either have to divest or restructure these securities. Because restructuring well over $130 billion of CLO securities is neither feasible nor under the control of the banks holding these notes, divestment is the most likely result. This, in turn, could lead to a fire sale scenario that could put incredible downward pressure on CLO securities prices leading to significant losses for U.S. banks. If prices decline by only ten percent, U.S. banks would have to recognize losses of almost $8 billion driven not by the underlying securities but solely because of the overreach of the Volcker Rule. Indeed, the final rules are already wreaking havoc on the CLO market. Since the final rules were announced, new CLO formation was down nearly 90 percent in January 2014, the lowest issuance in 23 months. If this situation is not remedied and CLO issuance remains moribund, corporate borrowers could face higher credit costs. At the hearing of the House Financial Services Committee on January 15, 2014, a number of both Democrats and Republicans asked questions about how to fix the issue with the CLO market that was not addressed in the interim final rule released on January 13, 2014. The representatives of the agencies noted that the CLO issue was at the top of the list of matters to be considered by the inter-agency working group that has been established to review issues such as this and publish guidance. The issue is urgent. Bank CFOs are struggling with how to treat their CLO debt securities. Can you commit to a tight time frame to issue guidance on CLOs?

A2: The agencies have taken the industry concerns regarding the treatment of CLOs under the Volcker Rule very seriously and, since the issue was first raised, have devoted considerable effort and staff resources to examining the industry concerns. For example, the agencies' staffs jointly have met with representatives of the Loan Syndication Trade Association, the American Bankers Association, the Structured Finance Industry Group, the Financial Services Roundtable and the Securities Industry and Financial Markets Association. Based on these discussions with the industry representatives, a review of data provided by market participants and discussions among the staffs of the agencies, we have found:

- Banking entities that hold legacy CLOs are undertaking a review of their particular holdings to evaluate where they fit within the treatment of covered funds under the

agencies' implementing regulations. Industry representatives have advised the staffs of the agencies that there is a great amount of variation from deal to deal in the restrictions applicable to investments permitted for CLOs and the rights granted to CLO investors. In addition, staffs of the agencies understand from the industry that many legacy CLOs may not satisfy the exclusion from the definition of covered fund for loan securitizations because they may hold a certain amount of non-conforming assets (such as bonds or other securities).

- New CLO issuances have been comparable in volume to the CLOs issued prior to the adoption of the implementing rules and sponsors have revised their new CLO deals to conform to the Volcker Rule's exception for loan securitizations. In particular, market participants have represented that new issuances of CLOs in late 2013 and early 2014 after issuance of the final rule are conforming to the final rule.[7]

- Data contained in the Call Report and Y9-C forms for asset-backed securities or structured financial products secured by corporate and similar loans indicate that U.S. banking entities hold between approximately $84 billion and $105 billion in CLO investments.[8] Of this amount, between approximately 94 and 96 percent are held by banking entities with total assets of $50 billion or more. Holdings of CLOs by domestic banking entities represent between approximately 28 to 35 percent of the $300 billion market for U.S. CLOs, with these holdings skewed toward the senior tranches.[9] These aggregate holdings reflect an unrealized net gain. Unrealized losses reported by individual banking entities are not significant relative to their tier 1 capital or income. Up to 52 domestic insured depository institutions (all charters) reported holdings of CLOs in their held-to-maturity, AFS and trading portfolios.[10]

To address the concerns regarding CLOs, the Federal Reserve Board issued a statement that it intends to grant two additional one-year extensions of the conformance period under section 619 that allow banking entities additional time to conform to the statute ownership interests in and sponsorship of CLOs in place as of December 31, 2013, that do not qualify for the exclusion in the final rule for loan securitizations.[11] The FDIC supports the statement issued by the Federal Reserve Board.

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[7] According to S&P, the majority of CLOs issued since the final rule have been structured as loan-only securitizations. First quarter 2014 CLO issuance stands at approximately $21 billion, according to Thomson Reuters PLC.

[8] This information is based on data compiled as of December 31, 2013, by the federal banking agencies, which undertook a review and analysis of CLO holdings of banking entities that are subject to filing Call Report or Y-9C data, including insured depository institutions, bank holding companies and certain savings and loan holdings companies.

[9] OCC supervised institutions hold the majority (95 percent) of this CLO exposure. These positions are concentrated in the largest institutions and are held mainly in the AFS portfolio.

[10] Based on Call Report data as of December 31, 2013.

[11] See Board Statement regarding the Treatment of Collateralized Loan Obligations Under Section 13 of the Bank Holding Company Act (April 3, 2014).

Q3: On a related point, we have heard that some are of the view that the guidance being sought by industry in connection with CLO debt securities is too broad. Isn't it the case that all the agencies have to do is issue extremely narrow guidance that states that a CLO debt security that has the right to replace a manager for cause, without any other indicia of ownership, will not be treated as an "ownership interest" under the Volcker Rule? Even if we were to concede (which we do not) that it would be difficult for the agencies to grant the requested relief, couldn't the agencies address the issue of legacy CLO securities by simply agreeing (as they did in the context of CDOs of Trups) to grandfather all existing CLO debt securities for CLOs issued prior to the publication of the final rules in the Federal Register? Wouldn't this very narrow relief fix the problem for banks that purchased CLO debt securities in good faith prior to the issuance of the final rule but are now facing potentially material losses?

A3: As noted above in the answer to question 2, the agencies have carefully considered the banking industry's concerns regarding bank CLO investments and their treatment under the Volcker Rule. After extensive interagency review of these issues, the Federal Reserve issued its statement announcing it would extend the conformance period for two additional years for certain CLOs. The agencies believe that the extension should address the compliance issues for many of the legacy CLOs that do not meet the loan securitization exemption, allowing many of them to mature or be called by investors, and should provide more time for CLO managers to evaluate and possibly change the composition of the underlying assets to bring the CLOs into conformance.

Response to questions from the Honorable Menendez
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Are you comfortable with the extent to which the consumer payments industry currently sets its own data security standards? Currently, most standards are set by contract – with the card companies playing a significant role – and an industry body known as PCI determines most of the details and certifies compliance examiners. Should federal regulators be playing a greater role?

A1: The FDIC recognizes the importance of effective self-regulatory standards such as PCI data security standards that set expectations between regulated card companies and businesses that handle payment card data, including retailers, payment processors, and others. While such self-regulatory models are an important part of data security, the federal banking agencies also established data security standards for financial institutions and those companies that do business with financial institutions including payment processors. These regulatory standards require financial institutions to develop and implement effective risk assessment and mitigation processes to protect customer information. These regulatory standards also require financial institutions to ensure that any third-party they do business with is also required contractually to comply with the same security rules for protecting customer information. Further, banking rules such as the Federal Reserve's Regulation E and Regulation Z are designed to protect consumers from payment card fraud, regardless of where a data breach occurs. The setting of standards for other aspects of the consumer payments industry is outside the federal financial regulatory structure. Whether additional involvement by the federal banking agencies should be authorized when those standards impact supervised institutions is a fair question for Congress to consider.

Q2: When a financial data breach occurs with a merchant (as seems to be the case with the current wave of data breaches) or other source outside of a financial institution, financial institutions still very clearly feel the effects. Credit and debit card issuers, for example, must notify affected customers and issue new cards, and will likely end up bearing some portion of the financial losses that occur from fraudulent transactions using stolen card information. In the chain of a retail payment transaction, security is only as strong as its weakest link.

a) In addition to the examinations the FDIC conducts regarding regulated institutions' own data security, can you describe the FDIC's oversight with respect to the security of consumer data across the entire chain of consumer payment transactions?

A2a: The FDIC's authority does not span the entire payment network. However, the federal banking agencies examine a number of nonbank payment processing companies that provide direct services to our regulated financial institutions as authorized by the Bank Service Company Act (12 U.S.C. 1867). Examination of these service providers attempts to identify potential systemic risks to the banking system and potential downstream risks to client banks.

When financial institutions partner with an outside party, they are exposed to additional risks, including reputation and financial risk if their customers' data is compromised. Given these risks, the FDIC seeks to ensure that the financial risk from third-party data breaches does not undermine the safety and soundness of the financial institutions.

b) Should federal regulators be taking a greater interest in the data security standards applicable to other entities that possess consumer financial data, beyond just regulated financial institutions? Are legislative changes necessary or are there legislative changes that would help?

A2b: Regulatory standards for protecting customer information (12 C.F.R 364, Appendix B) address financial institution responsibilities for data security. Our oversight, through on-site examination programs and enforcement authority for compliance failures, is designed to ensure data security standards for customer information are effectively implemented. Similarly, the Federal Trade Commission (FTC) can enforce standards for protection of customer information (16 C.F.R. 314) by all other financial institutions that are not insured depository institutions.

While financial institutions are subject to both industry standards and regulatory standards, others, such as merchants, are not subject to any national regulatory requirements to protect consumer data. If Congress chooses to review the Gramm-Leach-Bliley Act, or any other law, to determine whether customer protections should be expanded to non-financial institutions, the FDIC stands ready to assist. Further, the FDIC would recommend a review of the Bank Service Company Act to determine whether additional enforcement authority is necessary for the federal banking agencies with respect to non-bank financial institutions that provide direct services to banks.

Q3: In our economy today, companies are collecting and storing growing amounts of consumer information, often without consumers' knowledge or consent. The financial industry is no exception. We have heard reports of lenders, for example, mining online data sources to help inform underwriting decisions on consumer loans. As companies aggregate more data, however, the consequences of a breach or improper use become greater.

The Target breach illustrates the risks consumers face – not just of fraud, but also identity theft and other hardships. Compromised information included both payment card data and personal information such as names, email addresses, and phone numbers. But what if the next breach also involves account payment histories or Social Security numbers? As the ways companies use consumer information changes, and the amount of consumer data they hold grows, how is the FDIC's approach evolving? Are there steps regulators are taking – or that Congress should take – to require stronger protections against breaches and improper use, and to mitigate harm to consumers?

A3: Many nonbank companies aggregate consumer data, including credit reporting bureaus, tax preparers, health care providers, insurers, universities, and government agencies. The

FDIC concurs that protection of consumer data is critical across all entities. The FDIC is charged with ensuring that banks protect consumer data as authorized by the Gramm-Leach-Bliley Act (GLBA), Section 501(b). In response to GLBA, the FDIC and the other federal bank regulatory agencies developed the *Interagency Guidelines Establishing Information Security Standards* (12 C.F.R. 364, Appendix B) to protect customer information. With respect to protecting customer information, GLBA limits the FDIC's scope of enforcement authority to insured depository institutions. As discussed above, Congress might wish to review the Bank Service Company Act to determine if the Act adequately addresses third-party risk with respect to companies that provide direct services to banks.

Q4: A lot of the discussion in the aftermath of the recent data breaches has focused on credit and debit card "smart" chip technology, since the U.S. seems to have fallen behind other parts of the world such as Western Europe in adopting it. But while card chips help to reduce fraud for transactions where a card is physically present, and make it harder for thieves to print fake cards using stolen information, they do little to reduce fraud for online, "card-not-present" transactions.

a) Are you comfortable with the steps industry is taking to improve security and reduce fraud for "card-not-present" transactions?

A4a: As you indicate, card-not-present transactions may pose a higher risk to the merchant and the issuing bank. Absent adequate transaction authorization, the merchant may hold a greater degree of liability should fraud occur. Issuing banks that authorize transactions without sufficient fraud monitoring tools, or fail to respond to suspected compromised account notices from the card networks, could take on greater liability. However, the industry continues to struggle to provide effective security for "card-not-present" transactions. More needs to be done to ensure that there are protections in place to ensure proper authorization for these kinds of transactions, and to ensure that customer data remains protected. As on-line commerce continues to grow, so does this risk. With the upcoming implementation of the Europay, MasterCard and Visa (EMV) standard, there could potentially be a shift in fraud towards card-not-present transactions. To counter that potential, the industry should consider adopting new standards and technology. Examples include tokenization and end-to-end encryption as potential solutions.

b) Banks and other industry participants need to be proactive here, rather than waiting for a major breach to happen before making protective investments. Do you feel that regulated institutions are paying sufficient attention to all areas of data security risk, and are making the necessary investments to protect consumers rather than treating fraud as simply a cost of doing business?

A4b: As a general matter, the FDIC believes that the banks it supervises are complying with data security requirements and making necessary investments to protect customers from fraud. The FDIC assesses a financial institution's efforts to protect itself from financial risks such as fraud losses through risk mitigation processes, such as credit risk management and establishing credit risk reserves. Further, the Interagency Guidelines Establishing Information

Security Standards require financial institutions to implement an information security program that assesses risks to customer information, regardless of the potential for fraud losses. Such a program must assess risks to the confidentiality, integrity, and availability of customer information. The FDIC assesses the effectiveness of this program in banks we supervise as part of the FDIC's on-site examination process.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

March 11, 2014

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

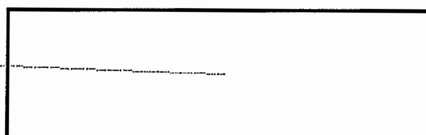
Dear Chairman Johnson:

Thank you for your letter enclosing questions from you and Senator Mark Kirk subsequent to the testimony by Diane Ellis, Director, Division of Insurance and Research, Federal Deposit Insurance Corporation at the Committee's November 21, 2013 hearing entitled, "Housing Finance Reform: Powers and Structure of a Strong Regulator."

Enclosed are our responses. If we can provide further information, please let us know. The Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)



Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

**Response to questions from the Honorable Tim Johnson
by Diane Ellis, Director, Division of Insurance and Research,
Federal Deposit Insurance Corporation**

Q1: S. 1217 proposes the regulator have, with the consent of other officials, emergency powers in a crisis that only lasts 6 months. Should we consider expanding that authority, or providing other counter-cyclical tools that a regulator may need in a future crisis?

A1: Since the length, depth, and frequency of financial crises are hard to predict, any emergency systemic risk authority should allow some flexibility in the frequency or duration of the use of that authority.

The FDIC has found it important to have sufficient authority and flexibility to respond to crises promptly in a way that maintains public confidence and financial stability. The FDIC has always been funded by the banking industry. Under section 7 of the Federal Deposit Insurance Act (FDI Act), 12 U.S.C. § 1817, the FDIC has the specific authority to raise assessment rates and charge special assessments and broad authority to require prepayment of assessments. The FDIC has used this authority to cover losses and maintain liquidity during periods marked by a high volume of bank failures. The FDIC also has lines of credit with the U.S. Treasury and the Treasury's Federal Financing Bank, and can borrow from the banking industry and from the Federal Home Loan Banks.

The FDIC's ability to access these lines of credit coupled with the U.S. government's full faith and credit backing of the FDIC's deposit insurance system reassures the public that the FDIC can pay its depositors promptly in the event of a bank failure, eliminating the risk of bank runs and panic. The lines of credit also reduce the likelihood of having to charge highly procyclical assessments. Ultimately, though, the banking industry would bear the costs of deposit insurance by repaying any emergency lines of credit were they to be drawn upon.

Q2: What is needed in legislation to ensure that federal and state regulators coordinate on supervision and resolution?

A2: The FDIC has found its supervisory and resolution authorities essential to fulfilling its mission of protecting depositors and maintaining financial stability. The FDIC coordinates with federal and state regulators under authorities provided by the FDI Act. These authorities include coordination and information sharing with other agencies, the ability to review examination findings for banks we do not supervise directly, and the ability to conduct backup examinations and reviews of those institutions as necessary.

The FDIC's most important tools in regulating entities primarily supervised by another agency are: (1) ongoing communications with the primary federal regulators and state supervisors, (2) maintaining clear standards for sharing information and examination reports, (3) coordinating examination schedules, and (4) working together on interagency issues through the Federal Financial Institutions Examination Council. The FDIC has maintained a Memorandum of

Understanding (MOU) with the other primary federal regulators (Office of the Comptroller of the Currency [OCC], Board of Governors of the Federal Reserve System [FRB], and the former Office of Thrift Supervision [OTS]) on Special Examinations for many years, the most recent version updated in 2010. In addition, the FDIC, FRB, OCC, and National Credit Union Administration entered into a MOU with the Consumer Financial Protection Bureau in May 2012 to implement supervisory coordination and information-sharing requirements in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

With respect to the proposed legislation, it is possible that many guarantors would already be subject to a regime of federal or state regulation and supervision, which also may include a process to handle insolvency. This underscores the need for clearly defined roles and rules for cooperation and coordination between the FMIC and the various federal and state regulators with authority over the guarantors. Where entities subject to the legislation are subject to oversight by other federal or state agencies, the legislation could clarify requirements for coordination of examination activities and information sharing agreements.

**Response to questions from the Honorable Mark Kirk
by Diane Ellis, Director, Division of Insurance and Research,
Federal Deposit Insurance Corporation**

Q1: The FDIC's mandate is made very clear as you note in your written testimony—"to protect depositors and maintain financial stability." The new FMIC will have both a supervisory role and a role to oversee the insurance fund. What do you think the mandate of the FMIC should be?

A1: Congress has given the FDIC a clear mandate: protect depositors and maintain financial stability. Congress has explicitly defined the amount of deposits covered under the FDIC deposit guarantee, and when insurance coverage is triggered (that is, when a bank fails). Clarity is important not just because it enables the FDIC to do its job, but because it establishes credibility in the eyes of depositors. The FDIC's explicit statutory authority assists in accomplishing our mission, and we rely on this authority along with supervisory tools to identify risk and take action to mitigate such risk.

The bill the Committee is considering clearly states two purposes of the FMIC: 1) to provide liquidity, transparency, and access to mortgage credit by supporting a robust secondary mortgage market and the production of residential mortgage-backed securities, and 2) to protect the taxpayer from having to absorb losses incurred in the secondary mortgage market during periods of economic stress. How to best balance these policy priorities is a question properly reserved for Congress.

Q2: Do you think that the FMIC will need two separate divisions—one for supervision and one for the insurance fund?

A2: Congress has consistently provided the FDIC with clear and explicit statutory responsibility and authority for creating a risk-based assessment system, maintaining a viable deposit insurance fund, supervising state nonmember banks, acting as backup supervisor for all insured banks, and resolving failed institutions. Congress has not mandated that the FDIC establish separate divisions for its insurance and supervision functions and, in general, Congress has left the FDIC's internal organization to the FDIC, although there are exceptions. For example, the FDIC is required to have a separate asset disposition division. While FMIC's internal structure is important, consideration also should be given to ensuring that FMIC has clear statutory responsibilities and authorities and sufficient discretion to respond to varying circumstances.

Q3: The FDIC currently manages exposure risk to the deposit insurance fund (DIF) at the time when insurance is granted to an institution but also while the insurance stays in force. In determining membership eligibility, the FDIC considers factors including financial history and condition of an institution, adequacy of the institution's capital structure, and a number of other factors. If there is one thing that Community Banks do not need it is one more Federal agency requesting information, doing examinations, and layering additional

standards and requirements onto them, which is time consuming and costly to the institution. To this end, do you think that institutions that are approved for FDIC insurance should be approved with far less rigor to have access to the FMIC insurance fund? Do you think that there could be coordination between the FDIC and the FMIC on the FDIC's ongoing monitoring and reporting requirements?

A3: As the primary federal regulator of most community banks, the FDIC understands the crucial role that community banks play in the American financial system. The FDIC has an ongoing responsibility to better understand the challenges facing community banks, and in early 2012 we launched a series of initiatives focusing on confronting those challenges. These initiatives remain an ongoing priority and include outreach programs, research, and improvements to make the supervisory process for community banks more efficient, consistent, and transparent.

Under the bill the Committee is considering, the FMIC would have to consider various factors before approving participation by four types of companies: private mortgage insurers, servicers, issuers, and bond guarantors. The factors for approving each of these companies are similar to, but not the same as, the statutory factors found in section 6 of the FDI Act, 12 U.S.C. § 1816, which the FDIC uses to determine eligibility for federal deposit insurance. The FDI Act factors include the financial history and condition of the institution, adequacy of the capital structure, future earnings prospects, general character and fitness of management, risk presented to the DIF, convenience and needs of the community to be served, and the consistency of the institution's corporate powers with the purposes of the FDI Act.

However, a bank's condition can change over time. For example, a change in ownership or business model can alter a bank's risk profile. Some banks are mismanaged or take on excessive risk, which can cause problems for the bank. If problems are severe enough, they can result in the bank's failure. Because a bank's condition can change over time, the FDIC and the other federal banking regulators are statutorily required to continue to monitor the condition of every bank after the bank receives deposit insurance. For example, every bank must file a quarterly report of condition and income. The FDIC and other banking regulators conduct periodic onsite examinations and require banks to take remedial action when deficiencies are noted.

The FMIC would be tasked with assessing potential risks of market participants in the secondary mortgage market, which is a different assessment than the FDIC makes for members of the deposit insurance system. Congress may wish to give the FMIC the authority to make the final determination on whether an institution has access to the FMIC insurance fund. Of course, to the extent there is overlap in the supervisory authority or requirements for granting admission to the deposit insurance system and for participation in the FMIC mortgage insurance system, it will be important for the FDIC, other banking regulators, and the FMIC to coordinate their efforts to avoid undue burden on participants of both systems. Under the FDI Act, the FDIC coordinates with other federal and state regulators, and the FDIC works on interagency issues through the Federal Financial Institutions Examination Council. Additionally, the FDIC has a longstanding Memorandum of Understanding with the other banking regulators (OCC, FRB, and the former OTS) to facilitate a coordinated approach to supervision. Where entities subject to the

legislation are subject to oversight by other federal or state agencies, the legislation could clarify requirements for coordination of examination activities and information sharing agreements.

Q4: The new FMIC will oversee a deposit-like insurance fund. Since it will have to be at least partially funded from day-1 of the new operation, how do you suggest that we consider getting initial capital for the fund? Do you recommend a gradual increase in premiums over time?

A4: The FMIC guarantee will cover an insurance exposure that generally rises with the volume of mortgages securitized under the FMIC. In recognition of this fact, the draft legislation mandates certain target levels for the size of the Mortgage Insurance Fund (MIF) in terms of a percentage of outstanding balances. This is analogous to the statutory reserve targets mandated for the FDIC Deposit Insurance Fund (DIF), which are expressed as a percent of estimated insured deposits.

While the proposed legislation suggests that FMIC would assess participants only at issuance (similar to the manner in which the government-sponsored mortgage enterprises (GSEs) currently impose guarantee fees), as opposed to an ongoing basis like the FDIC, it does not state so unambiguously.

Whichever assessment model the legislation or FMIC ultimately adopts, the FDIC's experience suggests that maintaining relatively consistent assessment rates over time will be important in avoiding procyclicality in insurance assessments and in providing for a stable competitive landscape between insured and non-insured financial activities. In that regard, the FDIC has learned from its experience that the flexibility to determine the proper fund size is important and that a hard target for a fund (that is, a particular size that a fund must remain) poses problems. During the 1990s through 2006, when Congress required a hard target for the size of the FDIC's insurance fund, a number of problems resulted, including a decade where at least 90 percent of the industry paid nothing for deposit insurance, a free-rider problem where new entrants and fast growers diluted the fund but paid nothing, and potentially volatile and pro-cyclical premiums.

Also, as our experience during the recent crisis shows, the net worth of the insurance fund at any given time is less important than the availability of cash, or working capital, to meet anticipated near-term insurance obligations. As such, there are a wide range of potential options for providing initial working capital to the FMIC, including an entrance fee for participating institutions, or loans from the federal government or the participating institutions themselves.

Q5: Also, you note that while a risk-based pricing system that is forward looking works much better than the former flat-rate system for the FDIC, you also note that this is not analogous with the federal mortgage insurance which might have alternative means of mitigating risk through underwriting standards etc. Do you, however think that there should be a graduated scale for insurance premiums, where larger users of the system pay more for the insurance—perhaps based on asset size or loan origination?

A5: The FDIC supports a risk-based pricing structure for deposit insurance. Under this system, banks that take on more risk pay more in deposit insurance, reducing the moral hazard problem. A federal mortgage insurer, however, is likely to have a greater ability to mitigate risk at the outset than the FDIC has, for example, by setting robust underwriting standards for the underlying mortgages.

In the event that a gradual pricing scale or a system that differentiates between large and small FMIC users is adopted, it may not serve the same function as a risk-based pricing system. Under the FDI Act, the FDIC is permitted to establish separate risk-based assessment systems for large and small banks. The FDIC has different methods for assessing large and small banks, but these separate pricing systems do not usually produce dramatically or systematically higher or lower average rates for either of these groups of banks. In fact, the range of possible assessment rates is the same under both systems. Moreover, recent changes to the deposit insurance assessment system under the Dodd-Frank Act shifted more of the assessment burden from community banks to the largest institutions in order to better reflect each group's share of industry assets.

Whatever pricing system is adopted for federal mortgage insurance, it is important that community banks have fair and equitable access to the secondary market for mortgages and to FMIC guarantees on terms that are not more expensive than for larger issuers. Without the ability for community banks to aggregate and securitize their loans, the scale economies in origination, servicing, and securitization could well impede the ability of community banks to compete in mortgage securitization.

Q6: It seems apparent that the Federal Government does not always price insurance appropriately. You note that through pre-funding, the FDIC is able to "smooth the cost" of insurance over time. However, the Designated Reserve Ratio (DRR) is truly a "soft target" and that it can often fluctuate which has led to instances when premiums are required to be increased during a crisis. How can we avoid instances where the FMIC will need to increase premiums during times of economic stress—times when institutions need to hold on to as much capital as possible? Doesn't having the ability to change rates inherently add the perverse incentive that industry will lobby the agency to lower rates during good times only to have to rates painfully increased during times of stress?

A6: The FDIC faces the problem of procyclical assessments, and in fact has charged procyclical assessments in the past, with high assessment rates during and immediately after the last two major banking crises and low average assessment rates between the crises. Under new authorities granted under the Dodd-Frank Act, however, the FDIC has adopted a long-term target for the fund that should allow us to reduce procyclicality, while assuring that the DIF has sufficient funds to remain positive even during crises of the magnitude of the last two. In meetings between the FDIC and individual bankers and banking industry trade groups, the industry has consistently supported the idea of avoiding procyclical assessments.

The FDIC has learned from its experience that the flexibility to determine the proper fund size is important and that a hard target for a fund (that is, a particular size that a fund must remain) poses problems. As discussed above, an inherent conflict exists between maintaining constant

rates and a specific, hard target fund size. During the 1990s and through 2006, Congress required a hard target for the size of the FDIC's insurance fund, which resulted in a decade where at least 90 percent of the industry paid nothing for deposit insurance. In contrast, allowing the fund to grow during good times should reduce premium procyclicality.

There are some significant differences between how the FDIC and the proposed FMIC would generate income, however. The FDIC assesses on bank liabilities every quarter, while the FMIC would assess transactions. FMIC's transaction-based assessments also may increase and decrease procyclically, that is, in line with overall economic activity. Congress may wish to consider ways to ameliorate this procyclical bias, for example, by charging sufficient fees during good times to build a fund large enough to withstand losses during a downturn.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

March 12, 2012

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to testify before the Committee at the December 6, 2011 hearing *Continued Oversight of the Implementation of the Wall Street Reform Act.*

Enclosed are my responses to the follow up questions you provided to complete the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

(b)(6)

Martin J. Gruenberg
Acting Chairman

Enclosure

Response to questions from the Honorable Richard Shelby
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: Chairman Gruenberg, in your testimony you discuss the FDIC's implementation of Title II of the Dodd-Frank Act and how the FDIC is preparing to resolve, if necessary, systemically significant institutions with its new orderly liquidation authority.

Had MF Global been deemed systemically significant before its collapse, would the FDIC have been able to resolve MF Global under Title II?

A1: Yes, the FDIC could have resolved MF Global had it been necessary.

The FDIC has the legal authority, technical expertise, and operational capability to resolve a systemically significant financial institution with its new orderly liquidation authority. Since the Dodd-Frank Act was enacted on July 21, 2010, the FDIC has established a new Office of Complex Financial Institutions. This new office is monitoring risk, conducting resolution planning, and coordinating with regulators overseas. We also have completed a series of rulemakings that implement our orderly liquidation authority under Title II of the Dodd-Frank Act and have finalized the joint rulemaking with the Federal Reserve Board to implement the resolution requirements ("living wills").

Q2: The agencies have submitted a proposed Volcker rule with over 1,300 questions, making it more of a concept release than a proposed rule. Additionally, the CFTC has not yet proposed its version of the Volcker Rule and might offer a competing version.

- **Given the complexity of the issues involved and that the CFTC has not signed on, do you anticipate extending the comment period?**
- **Do you anticipate doing a re-proposal?**

A2: On January 3, 2012, the agencies announced a 30-day extension of the comment period to February 13, 2012. On January 11, 2012, the CFTC approved its notice of proposed rulemaking to implement the Volcker Rule, with substantially identical proposed rule text as in the interagency notice of proposed rulemaking. The comment period extension was intended to facilitate public comment on the provisions of the rule and the questions posed by the agencies, as well as coordination of the rulemaking among the responsible agencies. The agencies will carefully consider the comments received on the proposed Volcker Rule in the development of the final rule and, as part of this review, will consider whether a re-proposal is necessary.

Q3: The agencies missed the October 18th statutory deadline for adopting a final Volcker rule, and despite agency delays, the rule is still scheduled to go into effect in July 2012. The Dodd-Frank Act had contemplated at least a nine month timeframe of advance preparation for compliance.

- **Do you believe there will be sufficient time for banking entities to adjust to all of the changes imposed by the rule?**
- **Would it make sense to phase in the implementation of the rule, so as to identify potential market disruptions caused by any single element of the rule?**
- **There is ample precedent for a phase-in, such as implementation of Regulation NMS. Do you believe the Volcker Rule calls for a similar phased-in approach?**

A3: The FDIC and the other agencies recognize the complexities associated with Section 619 of the Dodd-Frank Act and the care and attention required for implementing and complying with the new rules. Perhaps because of these complexities, the statute specifically provides affected companies with a minimum of two years to come into compliance with Section 619, which can be extended by rule or order by the Federal Reserve Board. Further, it is our understanding that many of the institutions affected by these proposed rules have begun preparing for their promulgation. However, although alternative approaches are not explicitly under consideration, the agencies continuously gauge the reasonableness of the implementation of rules and their impact on stakeholders.

Response to questions from the Honorable Mike Crapo
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: Last week the House Financial Services Committee passed unanimously a bill that exempts end-users from margin requirements. Proposed margin rules ignore the clear intent of Congress that margin should not be imposed on end-user transactions.

Do you all agree that end-user hedging does not meaningfully contribute to systemic risk, that the economy benefits from their risk management activity and that they should be exempt from margin requirements, and are you working together to provide consistent rules to provide end-users with a clear exemption from margin requirements?

A1: Nonfinancial end users appear to pose minimal risks to the safety and soundness of swap dealers and to U.S. financial stability when they hedge commercial risks with derivatives and the related unsecured exposure remains below an appropriate credit exposure threshold. Accordingly, the proposed rule does not specify a minimum margin requirement for transactions with nonfinancial end users. Rather, the proposed rule, consistent with long-standing supervisory guidance, would permit a swap dealer to adopt, where appropriate, its own thresholds below which the swap dealer is not required to collect margin from counterparties that are nonfinancial end users. In addition, low-risk financial end users, including most community banks, would not be required to post collateral for initial margin unless their activity exceeds either substantial thresholds or the risk limits set by the swap dealer with which they are doing business. Such thresholds are usually explicitly set forth in a credit support agreement or other agreement and are approved and monitored by the swap dealer as part of its own credit approval process.

As noted in the proposal, this approach is consistent with current market practices with respect to nonfinancial end users and low risk financial end users, in which swap dealers view the question of whether, and to what extent, to require margin from their counterparties as a part of the prudent credit decision process and consistent with safe and sound banking practices. Accordingly, the prudential regulators would expect that the direct costs and benefits of hedging with non-cleared derivatives by nonfinancial end users and low risk financial end users, including with respect to opportunity costs and earnings volatility, would remain unchanged relative to current market practices under the terms of the proposed rule.

In issuing the proposal, the prudential regulators requested comment on a variety of issues related to the effect of the proposed margin requirements on nonfinancial end users, including whether alternative approaches–such as an exemption similar to the mandatory clearing exemption–are preferable. We have received a variety of comments from members of the public, including commercial firms that use swaps to hedge their

risk. The prudential regulators will carefully consider all comments as we evaluate the proposal in light of comments received and formulate a final rule.

Response to questions from the Honorable Pat Toomey
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: As written, the proposed interagency rule to implement the so-called "Volcker Rule" would impose new and very substantial and costly compliance burdens on many banks that do not have a standalone proprietary trading desk or substantial fund investments, and never have. Specifically, the proposed rule would require these institutions to establish, at a minimum, policies and procedures designed to prevent the occurrence of activities in which the institution is not engaged -- in other words, the regulatory equivalent of proving a negative. It sounds to me like that could be a very costly undertaking for an institution that was never the intended target of the Volcker Rule. But more importantly, this makes even less sense given the economic challenges we face and the need to direct resources toward capital planning and lending.

Can you comment on why this is necessary? Is there a less onerous way to implement the permitted activities?

A1: We agree that banking organizations that are not engaged in activities or investments prohibited by the Volcker Rule should not face an onerous compliance burden. In fact, the proposed regulations specifically provide that such a banking organization will have been deemed to satisfy compliance requirements if its existing compliance policies and procedures include provisions designed to prevent the institution from becoming engaged in statutorily prohibited activities or making statutorily restricted investments. Further, for those banks that do engage in trading activities covered by the statute, the regulations provide an asset size threshold for the reporting and recordkeeping requirements, which provide smaller institutions with significantly less burdensome requirements. We recognize the importance of this issue and will carefully consider comments concerning implementation burden.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

April 5, 2012

Honorable Carolyn McCarthy
House of Representatives
Washington, D.C. 20515

Dear Congresswoman McCarthy:

Thank you for the opportunity to respond to your question submitted subsequent to testimony by Sandra Thompson, the Federal Deposit Insurance Corporation's Director of Risk Management Supervision, at the hearing on "H.R. 3461: the Financial Institutions Examination Fairness and Reform Act" before the House Subcommittee on Financial Institutions and Consumer Credit on February 1, 2012.

Enclosed are our responses. A copy was provided to Committee staff for the hearing record. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

(b)(6)

rely,

Paul Nash
Deputy to the Chairman for External Affairs

Enclosure

Response to questions
from the Honorable Carolyn McCarthy
By the Federal Deposit Insurance Corporation

Q1. The legislation requires regulatory agencies to develop and apply uniform definitions and reporting requirements for non-performing loans. Ensuring that standards work for both small and large financial institutions, while also giving the agencies flexibility to continue to address unique situations of smaller institutions is vital.

Do you feel uniform standards for non-performing loans are achievable, or are there alternative ways to provide for consistency of the loan classification process?

A1: All insured banks must currently apply a uniform definition of nonaccrual loans[1] contained in the FFIEC's Consolidated Reports of Condition and Income when they report quarterly financial information to the Federal Banking Agencies (Agencies). The instructions indicate – in part - that:

> *Banks shall not accrue interest, amortize deferred net loan fees or costs, or accrete discount on any asset (1) which is maintained on a cash basis because of deterioration in the financial condition of the borrower, (2) for which payment in full of principal or interest is not expected, or (3) upon which principal or interest has been in default for a period of 90 days or more unless the asset is both well secured and in the process of collection.*

In addition, the instructions provide additional details on related topics such as exceptions to the general rule, criteria of when a loan can be restored to accrual status, etc. While the definition does require the use of some judgment, we should note that most banks – both large and small – have been able to appropriately apply this definition for many years and across economic cycles.

Similarly, the federal banking agencies follow uniform definitions related to the classification of problem assets. In this case, the *Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts.* Loan classification standards are consistently applied at FDIC examinations, and we ensure our conclusions are balanced and equitable through discussions with bank management and a rigorous secondary review of examiners' findings. In most cases, our experience shows that our loan classifications validate the banks' own internal credit risk ratings.

We believe that the *Call Report* definition for nonaccrual loans, and the *Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts*, provide significant consistency in the loan classification process. We are concerned that the modifications proposed to these supervisory tenets could result in regulatory reporting that is less stringent than generally accepted accounting principles. This may impede the effective identification of credit deficiencies and proper accrual of interest income and, ultimately, the issuance of corrective action by the banking supervisors.

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[1] The proposed legislation requires that the Federal financial institutions regulatory agencies shall develop and apply identical definitions and reporting requirements for non-accrual loans.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

April 5, 2012

Honorable Lynn A. Westmoreland
House of Representatives
Washington, D.C. 20515

Dear Congressman Westmoreland:

Thank you for the opportunity to respond to your questions submitted subsequent to testimony by Sandra Thompson, the Federal Deposit Insurance Corporation's Director of Risk Management Supervision, at the hearing on "H.R. 3461: the Financial Institutions Examination Fairness and Reform Act" before the House Subcommittee on Financial Institutions and Consumer Credit on February 1, 2012.

Enclosed are our responses. A copy was provided to Committee staff for the hearing record. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

(b)(6)

erely,

Paul Nash
Deputy to the Chairman for External Affairs

Enclosure

Response to questions
from the Honorable Lynn Westmoreland
By the Federal Deposit Insurance Corporation

Q1. How many examiners have been disciplined since 2008? How many were disciplined for not fully utilizing standard agency guidance for examination procedures?

A1: The FDIC makes great efforts to ensure that our examiners understand and abide by applicable policies and procedures for examinations of financial institutions. Examiners train for three years or more to become commissioned examiners and cannot lead an examination until they are commissioned. As a result, we have very few instances of examiners being disciplined for performance or behavior related to their examination work at a financial institution. Since 2008 the FDIC has disciplined four examiners for inappropriate behavior during an examination and there were no instances of an examiner being disciplined for not utilizing standard agency guidance for examination procedures.

Q2: How many examiners have had employment terminated since 2008 as a result of poor performance?

A2: Nineteen examiners have been terminated due to poor performance since 2008, the majority of which were related to their inability to meet the benchmarks and testing requirements to reach commissioned status.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

April 30, 2012

Honorable Tim Johnson
Chairman
United States Senate
Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to testify before the Committee at the March 22, 2012 hearing *International Harmonization of Wall Street Reform: Orderly Liquidation, Derivatives, and the Volcker Rule.*

Enclosed are my responses to the follow up questions from Senator Toomey to complete the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Paul Nash, Deputy for External Affairs, at (202) 898-6962.

Sincerely,

(b)(6)

Martin J. Gruenberg
Acting Chairman

Response to Questions from the Honorable Pat Toomey by Martin J. Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation

Q1. The proposed Volcker Rule applies to all companies that own an insured depository, and all subsidiaries and affiliates. In addition to traditional banks and bank holding companies, the rule seems to fully cover commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate." (Under the Bank Holding Company Act, investments as low as 5% can trigger affiliate status.) The so-called goal of the Volcker rule was designed to limit risks at insured depositories so that banks wouldn't be using government-insured deposit funds to "gamble" through proprietary trading or fund investing. But it seems that in reality, the rule will cover all sorts of industrial and commercial companies just because they are in some way "affiliated" with a depository. Similarly, the rule would cover a company that makes a large investment in another company that controls a depository, dissuading these types of strategic investments for fear of the investor becoming "infected" with the Volcker Rule.

Does it make any sense to apply the full restrictions and regulatory requirements to non-financial companies?

What can your agencies do in the regulations, particularly regarding your standards for determining what is an "affiliated" company, to make sure that the Volcker Rule does not burden non-financial companies in a way that was completely unintended by Congress?

A1. The definition of "banking entity" in the proposed rules implementing the Volcker Rule[1] as issued by the federal banking agencies and the Securities Exchange Commission (collectively, the Agencies) is substantively similar to the definition of that term in section 13(h)(1) of the Bank Holding Company Act (BHCA) as added in the Volcker Rule. The definition covers: (1) any insured depository institution; (2) any company that controls an insured depository institution or is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978[2]; and (3) any affiliate or subsidiary of any such entity.[3]

In the preamble of the notice of proposed rulemaking implementing the Volcker Rule (NPR), the Agencies provided a clarification of the definition of "banking entity" with

[1] *See* 76 Fed. Reg. 68846 (November 7, 2011). For the separate notice of proposed rulemaking of the Commodity Futures Trading Commission, *see* 77 Fed. Reg. 8332 (February 14, 2012).

[2] 12 U.S.C. 3106

[3] 12 U.S.C. 1851(h)(1).

respect to affiliates or subsidiaries of insured depository institutions and bank holding companies. This clarification provided that the definition of "affiliate" and "subsidiary" under the BHCA is broad. The clarification also provided a limited exception that clarified how the term "banking entity" would not apply to certain covered funds under the Volcker Rule.[4] However, neither the Volcker Rule nor the proposed rules provide for an exception to exclude affiliates or subsidiaries of insured depository institutions or bank holding companies that are non-financial, commercial companies.

To address issues involving the definition of "banking entity" in the proposed rules, the Agencies provided the following questions that generally cover your questions regarding that definition:

> Question 5. Is the proposed rule's definition of banking entity effective? What alternative definitions might be more effective in light of the language and purpose of the statute?
>
> Question 6. Are there any entities that should not be included within the definition of banking entity since their inclusion would not be consistent with the language or purpose of the statute or could otherwise produce unintended results? Should a registered investment company be expressly excluded from the definition of banking entity? Why or why not?[5]

The Agencies, including the FDIC, will seriously consider the various specific comments that have been received in response to the NPR in the development of the final rule.

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[4] *See* 76 Fed. Reg. 68855 - 68856

[5] *See* 76 Fed. Reg. 68856 (November 7, 2011).

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

June 4, 2012

Honorable Spencer T. Bachus
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for your follow-up questions to the joint hearing of the Subcommittee on Capital Markets and Government Sponsored Entities and the Subcommittee on Financial Institutions and Consumer Credit of the House Financial Services Committee entitled "Examining the Impact of the Volcker Rule on Markets, Businesses, Investors and Job Creation." I apologize for the delay in responding.

As I testified during the hearing, the agencies' proposal for the implementation of section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Volcker Rule) is intended to allow banking entities to continue to engage in permitted activities consistent with the statutory mandates and without undue impact on market liquidity. Such activities include bona fide market making and underwriting activities, risk-mitigating hedging, trading activities on behalf of customers, and investments in covered funds.

Your questions concern the manner in which the FDIC plans to respond to various specific comments that have been received in conjunction with the agencies' joint notice of proposed rulemaking (NPR). The issues you raised were important enough that the agencies posed questions and requested comment on each one in the NPR. I assure you that we will seriously consider all comments received as we move forward in the final rulemaking.

Regarding question 9, which recommended the agencies' development of a general cost-benefit analysis of the proposal, please note that for rulemakings, the FDIC conducts various types of economic impact assessments for all proposed and final rules. For final rules, under the Congressional Review Act, the FDIC determines, among other factors, whether a final rule is likely to result in a $100 million or more annual effect on the economy. For proposed and final rules, under the Regulatory Flexibility Act, the FDIC determines if a proposed or final rule is likely to have a "significant economic impact on a substantial number of small entities." As noted in my testimony, the agencies have taken an initial look at the potential economic impact on small banking entities and concluded that the proposed rule will not result in a significant economic impact on small banks. The Agencies based this conclusion on two primary factors: (1) while the proposed rule, per statutory requirements, covers all banking entities, significant reporting and recordkeeping requirements apply only to banking entities with consolidated

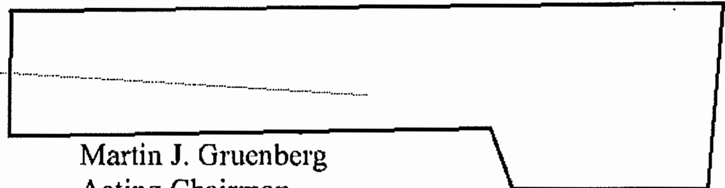
trading assets and liabilities and aggregate covered fund investments greater than $1 billion, respectively, or where trading assets are more than 10 percent of total assets; and (2) the compliance program requirements under the proposed rule are established in a manner that mainly impacts entities engaged in covered trading or fund activities–activities that are not typical of small banks. In addition, in this rulemaking the agencies have encouraged public comments on this issue and have asked commenters to include empirical data to illustrate and support the potential impact on small banks.[1] Also, see questions 348 – 383 in the NPR, which concern the economic impact of various provisions in the joint proposed rule.[2]

Enclosed are responses to the questions from other Members of the Committee. I also have sent responses to the Members directly.

If you have additional comments on the Volcker Rule NPR, please feel free to contact me at (202) 898-3888, or Alice C. Goodman, Acting Director, Office of Legislative Affairs, at (202) 898-8730.

Sincerely,

(b)(6)



Martin J. Gruenberg
Acting Chairman

Enclosures

[1] *See* 76 Fed. Reg.68846, 68939 (November 7, 2011).
[2] *Id.* at 68933 – 68936.

Response to Questions from the Honorable Judy Biggert
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Your questions concern the timing for the issuance of the interagency final rule to implement the Volcker Rule, the process for a phased-in implementation of the final rule's compliance regime, and the regulatory authority for the respective agencies in achieving regulatory compliance with the Volcker Rule in a measured manner.

While it remains our desire to finalize the regulations by July 21, 2012, we note that full conformance is not required by that date. The Federal Reserve Board on April 19, 2012, issued a Statement of Policy that clarified the implementation of the Volcker Rule during the conformance period for banking entities engaged in prohibited proprietary trading or sponsored private equity fund or hedge fund activities.[3] In addition, the notice of proposed rulemaking on the Volcker Rule, which was issued by the federal banking agencies and the U.S. Securities and Exchange Commission on November 7, 2011, provides further clarification of those conformance regulations by the Federal Reserve Board.[4]

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[3] *See* Board of Governors of the Federal Reserve System, *Statement of Policy Regarding the Conformance Period for Entities Engaged in Prohibited Proprietary Trading or Private Equity Fund or Hedge Fund Activities*, April 19, 2012.

[4] *See* 76 Fed. Reg. 68846, 68922 - 68923 (November 7, 2011).

**Response to Questions from the Honorable Gary Peters
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation**

Your questions concern whether the agencies agree that covered entities under the Volcker Rule might decrease market-making activity as a result of the Volcker Rule. In such a financial markets situation, you asked whether any such decreases in liquidity would result in other parties providing the requisite liquidity. Regarding such new market-making participants, you asked "what kinds of institutions do you expect will emerge to provide the liquidity necessary for well functioning markets, and what kind of regulatory scrutiny are those institutions subject to?"

You also had questions which involve issues on the application of the Volcker Rule to affiliates of insured depository institutions, including commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate."

Since we currently are reviewing the various issues presented in this rulemaking for purposes of the final rule, we cannot provide a definitive answer to your questions, which also were raised by certain commenters. Note that question 83 as provided in the preamble of the NPR asked similar questions involving the impact on the "liquidity, efficiency, and price transparency of capital markets."[5]

We agree that the issues you raise are important, and the agencies posed questions and requested comment on them. I can assure you that we will carefully consider your concerns and all comments received as we move forward in the final rulemaking.

[5] *Id.* at 68870.

Response to Questions from the Honorable Bill Huizenga
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Your questions involve issues on the application of the Volcker Rule to affiliates of insured depository institutions, including commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate."

Since we are reviewing the options for the various issues presented in this rulemaking to implement the Volcker Rule, we cannot provide a definitive answer to your questions, which also were raised by certain commenters. Please be assured that we will carefully consider your questions in conjunction with our development of the final rule. Question 6 of the preamble of the NPR asked for comments on entities that should not be covered in the definition of "covered entity" in the proposed rule.[6]

The questions you raise present significant issues of law and policy that will be addressed in the final rule for the implementation of the Volcker Rule.

[6] Id. at.68856.

Response to Questions from the Honorable Michael Grimm
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Your questions involve the impact of the Notice of Proposed Rulemaking for the Volcker Rule on various proprietary trading activities conducted by "non-U.S. based institutions" with various categories of U.S. and foreign counterparties. Please note that the Volcker Rule applies to proprietary trading and covered fund activities by certain "covered entities" that generally are U.S. insured depository institutions and their affiliates and subsidiaries.

Since we currently are reviewing the various issues presented in this rulemaking for purposes of the final rule, we cannot provide a definitive answer to your questions, which also were raised by certain commenters. Please be assured that we will carefully consider your questions in conjunction with our development of the final rule.

The questions you raise present significant issues of law and policy that will be addressed in the final rule for the implementation of the Volcker Rule.

Response to Questions from the Honorable Carolyn McCarthy
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

You ask what possible changes the regulators should be thinking about or are necessary as the result of stakeholder feedback on the Notice of Proposed Rulemaking (NPR) for the Volcker Rule. This section of the Dodd-Frank Act is designed to strengthen the financial system and constrain the level of risk undertaken by firms that benefit from the safety net provided by federal deposit insurance or access to the Federal Reserve's discount window. The challenge to regulators in implementing the Volcker Rule is to prohibit the types of proprietary trading and investment activity that Congress intended to limit, while allowing banking organizations to provide legitimate intermediation in the capital markets.

In response to the NPR, the regulators have received a high volume of comments from stakeholders, suggesting many issues and changes that we should think about in drafting the final rule. We are carefully reviewing these comments as they raise significant issues of law and policy.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

June 26, 2012

Honorable Lynn A. Westmoreland
House of Representatives
Washington, D.C. 20515

Dear Congressman Westmoreland:

This letter is in response to your request for information during the testimony of Bret Edwards, Director, Division of Resolutions and Receiverships, on May 16, 2012, at the hearing entitled "Oversight of the Structured Transaction Program" before the Subcommittee on Oversight and Investigations of the House Financial Services Committee.

You asked for examples of the Federal Deposit Insurance Corporation funding loan commitments on acquisition, development, and constructions loans since 2008. Since 2008, the FDIC as receiver has funded over 1,100 commitments for approximately $396 million. Enclosed is a detailed report prepared by the Federal Deposit Insurance Corporation's Division of Resolutions and Receiverships for the hearing record.

We hope that this information is helpful. If you have further questions, please do not hesitate to contact me at 202-898-8730, or Ike Jones, Legislative Attorney and Advisor, at 202-898-3657.

Sincerely,

(b)(6)

Alice C. Goodman
Acting Director
Office of Legislative Affairs

Enclosure

cc: Honorable Randy Neugebauer
Chairman, Subcommittee on Oversight and Investigations

Honorable Michael E. Capuano
Ranking Member, Subcommittee on Oversight and Investigations

Response to questions from the Honorable Lynn A. Westmoreland
by Bret Edwards, Director, Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

FDIC Receivership Funding and Repudiation of Unfunded Loan Commitments

As receiver for a failed institution, the Federal Deposit Insurance Corporation has a legal responsibility to maximize recovery for the benefit of depositors and creditors who may have lost money when the institution failed. In accordance with this responsibility, the FDIC must carefully analyze any requests for funding construction projects as well as evaluate the risks associated with the proposed transaction, to determine whether the funding will provide the best opportunity to achieve the highest possible recovery for the failed institution's estate. The FDIC's Division of Resolutions and Receiverships staff review each funding request on a "case-by-case" basis. If the advancement of funds for construction purposes will result in a net increase in the underlying collateral value or such funds will protect, preserve, or allow for build-out so that marketing of the real estate project can immediately begin, the FDIC as receiver may advance such funds. Since 2008, the FDIC as receiver has funded over 1,100 commitments for approximately $396 million. Attached is a summary of the loan fundings by state.

At times, the statutory responsibilities of the FDIC have a necessary yet unintended consequence of delaying funding of construction draws for builders and developers as our receivership staff determine the value and viability of the construction project as well as the companies who have pledged to repay those loans. In some instances, following a detailed review of the project plans, appraisals, and current financial information from the company and/or guarantors, the receiver will make the decision that continued funding of a project will not minimize losses nor maximize recovery for the receivership estate and thus, the receivership will terminate funding on construction projects.

The overarching goal of the receiver is to wind up the affairs of the failed financial institution. In order to achieve that goal, the receiver is given the right under 12 U.S.C. Section 1821(e) to repudiate undertakings entered into by the failed financial institution where it finds such undertakings to be burdensome and where such repudiation will promote the orderly administration of the failed financial institutions affairs.

Accordingly, our receivership management personnel work to achieve a balance between making financial decisions that are in the best interests of the receivership estate while being cognizant of business decisions that may have an adverse financial impact upon construction companies, real estate developers, and small business enterprises–and to those they employ. Immediately following the failure, the FDIC contacts the loan customers of the failed bank to stress the importance of establishing a banking relationship with a local financial institution that will be able to provide on-going traditional lending and financing. We are aware that at many locations around the nation, the depreciating real estate environment has made it exceptionally difficult for many failed bank customers and business owners in the construction industry to successfully transition their banking relationships in an effort to obtain new lending sources. Nevertheless, we must base our decisions regarding continued funding of loans from a failed bank on our statutory duty to minimize losses and maximize recoveries for the failed bank receiverships.

Attachment

FDIC Receivership Funding of Unfunded Loan Commitments				
Failed Financial Institution	Failed Financial Institution City	State	Number of Fundings	Total Amount of Funding
1st Centennial Bank	Redlands	CA	8	$3,635,453
1st Heritage Bank	Newport Beach	CA	1	$301,062
1st National Bank of Nevada	Reno	NV	185	$54,723,452
Alpha Bank & Trust	Alpharetta	GA	8	$2,189,522
AmeriBank	Welch	WV	3	$349,455
AmTrust Bank	Cleveland	OH	9	$14,543,336
ANB Financial	Bentonville	AR	51	$20,030,895
Bank of Clark County	Vancouver	WA	6	$1,681,439
Bank of the Commonwealth	Norfolk	VA	1	$491,253
Bank of Wyoming	Thermopolis	WY	1	$50,000
Barnes Banking Company	Kaysville	UT	1	$250,000
Broadway Bank	Chicago	IL	2	$2,080,535
Centennial Bank	Ogden	UT	1	$45
Citizens Community Bank	Ridgewood	NJ	1	$21,070
Colonial Bank	Montgomery	AL	78	$2,974,274
Columbian Bank & Trust	Topeka	KS	6	$2,316,995
Community Bank of Nevada	Las Vegas	NV	2	$147,568
Community Bank of West Georgia	Villa Rica	GA	3	$794,628
Corn Belt Bank & Trust	Pittsfield	IL	1	$53,593
Corus Bank	Chicago	IL	10	$15,212,201
First Bank of Beverly Hills	Calabasas	CA	41	$16,404,157
First Bank of Idaho	Ketchum	ID	7	$461,824
First Georgia Community Bank	Jackson	GA	2	$27,000
First Integrity Bank	Staples	MN	1	$28,691
FirstCity Bank	Stockbridge	GA	32	$2,443,255
Florida Community Bank	Immokalee	FL	3	$205,427
Franklin Bank SSB	Houston	TX	148	$27,051,080
Freedom Bank	Bradenton	FL	1	$49,598
Haven Trust Bank	Duluth	GA	24	$14,981,926
Home Savings of America	Little Falls	MN	96	$21,281,615
Independent Banker's Bank	Springfield	IL	6	$2,888,111
IndyMac Federal Bank FSB	Pasadena	CA	2	$30,994
Integrity Bank	Alpharetta	GA	2	$402,201
Irwin Union Bank & Trust	Columbus	IN	1	$6,055
La Jolla Bank FSB	La Jolla	CA	2	$46,950
MagnetBank	Salt Lake City	UT	3	$118,882
Main Street Bank	Northville	MI	9	$876,068
Miami Valley Bank	Lakeview	OH	1	$24,095
Netbank	Alpharetta	GA	2	$154,000
New Frontier Bank	Greeley	CO	7	$255,039
Ocala National Bank	Ocala	FL	2	$85,093
Republic Federal Bank	Miami	FL	1	$115,971
Riverside Bank of the Gulf Coast	Cape Coral	FL	6	$368,043
RockBridge Commercial Bank	Atlanta	GA	2	$591,194
Sanderson State Bank	Sanderson	TX	1	$62,000
Security Pacific Bank	Los Angeles	CA	3	$767,367
Security Savings Bank	Henderson	NV	7	$9,930,143
Silver State Bank	Henderson	NV	32	$10,783,105
Silverton Bank	Atlanta	GA	151	$158,302,965
Tennessee Commerce Bank	Franklin	TN	2	$255,697
The Bank of Bonifay	Bonifay	FL	3	$43,635
The Community Bank	Loganville	GA	7	$1,174,130
Union Bank	Gilbert	AZ	2	$393,260
Warren Bank	Warren	MI	8	$1,916,013
Westsound Bank	Bremerton	WA	16	$1,767,822
Grand Total			**1011**	**$396,140,184**

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

June 25, 2012

Honorable Michael E. Capuano
Ranking Minority Member
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congressman Capuano:

This letter is in response to your request for information during the testimony of Bret Edwards, Director, Division of Resolutions and Receiverships, on May 16, 2012, at the hearing entitled "Oversight of the Structured Transaction Program" before the Subcommittee on Oversight and Investigations of the House Financial Services Committee.

At the hearing you asked for an explanation of the price paid by Rialto for its 40 percent equity interest in the two structured transactions with the Federal Deposit Insurance Corporation. Enclosed is a report prepared by the Federal Deposit Insurance Corporation's Division of Resolutions and Receiverships of the economic structure of those transactions and the price paid by Rialto.

We hope that this information is helpful. If you have further questions, please do not hesitate to contact me at 202-898-8730, or Ike Jones, Legislative Attorney and Advisor, at 202-898-3657.

Sincerely,

(b)(6)

Alice C. Goodman
Acting Director
Office of Legislative Affairs

Enclosure

cc: Honorable Randy Neugebauer
Chairman, Subcommittee on Oversight and Investigations

Response to questions from the Honorable Michael E. Capuano
by Bret Edwards, Director, Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

During the hearing, there were a number of questions regarding the financial aspects of the structured transactions entered into by the FDIC with Rialto Capital Management (Rialto) and per the Committee's request, below we attempt to provide a simple and clear explanation of the economics of structured transactions generally and that deal in particular.

For those unfamiliar with the FDIC's structured transaction program, it may prove useful to walk through a simple example to explain the economics of these transactions. Assume the following facts:

Example 1: Unleveraged transaction

- FDIC as receiver inherits one severely delinquent loan with an unpaid principal balance (UPB) of $100.
- FDIC's financial advisor estimates an immediate cash sale of the loan would bring $40. (In other words, the loan would only be worth 40 cents on the dollar if sold immediately for cash)
- FDIC as receiver forms an LLC and contributes the loan to an LLC in exchange for a 100 percent ownership interest in the LLC.
- FDIC offers to sell a 40 percent equity interest in the LLC (while FDIC retains 60 percent).
- The winning bidder in a highly competitive sale offers to pay $25 for the 40 percent equity interest and FDIC closes the sale.
- The "Implied Value" of the loan in the structured sale is based on the highest bid and is calculated to be $62.50. That is, if someone pays you $25 for 40 percent of something, then the value they are placing on the entire thing—in this case, a defaulted loan—is simply $25/.40, or $62.50. Note the FDIC as receiver is retaining 60 percent of the equity of the LLC, so by definition, its share is valued at $37.50 (or $62.50 - $25).
- Given the FDIC's financial advisor's estimate of the loan's value in an immediate cash sale of $40, the FDIC achieves a much better return by putting this loan in a structured sale. Specifically, the FDIC will receive $25 immediately and is expected to receive $37.50 over time as the asset is worked within the LLTC structure. This total of $62.50 compares very favorably to the $40 it was expected to have received had it sold the loan immediately. Indeed, it may be argued that the FDIC is statutorily required to engage in these transactions because they achieve the least loss resolution of failed bank assets (in this case, $22.50 additional return) that the structured sale vehicle provides.
- A comparison of what the winning bidder paid to the UPB of this severely delinquent loan is misleading. First, suggesting that the winning bidder paid "25 cents on the dollar" for this loan ignores the fact that the winning bidder is only purchasing 40 percent of the equity in the LLC. So by that measure, it is more accurate to state it paid 25 cents on 62.5 cents for its 40 percent share of the LLC. Second, the inference that any discount amount or percentage off the UPB constitutes a "sweetheart" deal ignores the fact that this loan is severely delinquent and thus by definition, is worth substantially

less than the UPB. Indeed, we would argue the winning bidder paid market value for its equity share of the LLC in a competitive sale and therefore there was no "sweetheart" deal.

- It is important to note that the likely value of the loan is greater than $62.50. Remember that each dollar of recovery in the LLC is split 60 percent/40 percent with the FDIC. Hence, the winning bidder does not achieve a return of its initial investment until collections on the loan reach the $62.50 level. The winning bidder is betting that it can collect more than that and thus achieve a return on its initial investment of $25.

Example 2: Leveraged transaction

- FDIC as receiver inherits one severely delinquent loan with an UPB of $100.
- FDIC's financial advisor estimates an immediate cash sale of the loan would bring $40. (In other words, the loan would only be worth 40 cents on the dollar if sold immediately for cash)
- FDIC as receiver forms an LLC and contributes the loan to an LLC in exchange for a 100 percent ownership interest in the LLC.
- The FDIC as receiver then offers to sell a 40 percent interest in the equity portion of the LLC (while FDIC retains a 60 percent interest).
- In order to induce greater competition for the structured sale, the FDIC offers leverage in the transaction. It does this by inducing the LLC to pay for 50 percent of the assets the FDIC as receiver contributed to the LLC by issuing a note payable to the receiver. This allows the winning bidder to put in half as much initial cash as it would in the unleveraged example. Importantly, this debt must be paid back in full from the cash flow generated by the LLC before any equity distributions are made to the LLC members.
- The winning bidder in a highly competitive sale offers to pay $12.50 for the 40 percent equity interest and FDIC closes the sale. Although the bidder paid only half the cash it would have an unleveraged deal, the implied value of the assets remain $62.50.
- As above, a comparison of what the winning bidder paid to the UPB of this severely delinquent loan is misleading. First, suggesting that the winning bidder paid "12.5 cents on the dollar" for this loan ignores the fact that the winning bidder is only purchasing 40 percent of the equity portion of the LLC, and that the equity portion is only 50 percent of the total capital of the LLC given the issuance of the purchase money note. So by that measure, it is more accurate to state it paid the equivalent of 12.5 cents on 31.25 cents for its 40 percent share of the equity portion of the LLC. And as above, the inference that any discount amount or percentage constitutes a "sweetheart" deal ignores the fact that this loan is severely delinquent and thus by definition, is worth substantially less than the UPB. Indeed, we would argue as we did in Example #1, that the winning bidder paid market value for its equity share of the LLC in a competitive sale and therefore there was no "sweetheart" deal.

The Specifics of the Rialto Deal

In February 2010, the FDIC closed two Structured Transactions (LLCs) with Rialto. The two transactions were composed of 5,511 distressed acquisition and development (ADC) loans representing approximately $3.1 billion in UPB. These loans were severely distressed—over 80

percent of the asset portfolio was greater than 150 days delinquent at the time of the sale. Hence, the market value of these loans was significantly lower than the UPB at the time of sale just as we noted in the examples above. Rialto paid the FDIC as receiver approximately $243 million in cash for a 40 percent equity interest in the two leveraged LLCs. The FDIC retained the remaining 60 percent equity interest, which had an implied value of approximately $365 million. Additionally, the LLCs issued approximately $627 million in purchase money notes to the FDIC as receiver. The FDIC competitively bid the equity interests in the LLCs with the sale notification being sent to more than 960 prequalified bidders, and bid packages sent to more than 57 potential bidders.

Using logic similar to that outlined in the examples above, Rialto did not pay "8 cents on the dollar" for $3.1 billion in assets. In fact, Rialto paid approximately $243 million for a 40 percent interest of the equity portion of the LLCs. While Rialto manages the day-to-day administration of the portfolio, it does not realize a recovery on its equity interest until the LLC fully repays the purchase money notes. Rialto's purchase price for its equity interest is the basis for establishing the implied value of the loan portfolio as a whole.

Similar to the definition of implied value outlined above, it is the sum of Rialto's equity interest, the FDIC's equity interest and the UPB of the purchase money notes at issuance. The implied value is calculated by adding the combined equity interests to the debt issued (which includes a guaranty fee of approximately $18 million payable to the FDIC) and then dividing the total by the UPB of the portfolio. The implied value of the loan portfolio owned by the LLCs as illustrated and calculated below is approximately 40.5 percent.

When applying the purchase price definition and calculation to the Rialto structured sale the following purchase price is achieved based on the structure offered for this sale which was 1:1 debt to equity, 60 percent and 40 percent equity split to the FDIC and Rialto, respectively:

Unpaid Principal Balance of ADC Loan Portfolio	$3,052,645,902
Rialto Bid to Purchase 40 percent Equity Interest	$243,458,812
Divided by Rialto Equity percent	40 percent
Total Implied Value of Equity ($243MM/0.40=$608.6MM)	$608,647,030
Purchase Money Notes before guaranty fee (1:1 debt/equity)	$608,647,030
FDIC Corporate Guaranty Fee (3 percent)	$18,259,411
Total Purchase Money Note	$626,906,441
Total Loan Portfolio Value based on Sales Price	$1,235,553,471
Portfolio Unpaid Principal Balance Sold	$3,052,645,902
Calculated Implied Value ($1.235B divided by $3.052B)	40.5 percent

While the implied value is 40.5 percent, the FDIC received approximately (i) $243 million in cash upfront from Rialto for Rialto's equity interest in the LLCs, and (ii) $627 million in purchase money notes. Recoveries after the LLCs fully repay the purchase money notes are split 60 percent for FDIC and 40 percent for Rialto.

In order for Rialto to receive a return on its equity investment, the LLCs must recover in excess of $1.2 billion. The $1.2 billion consists of the LLCs repayment of the $627 million in purchase money notes plus $608 million in equity disbursements. The $608 million is derived by adding the approximately $243 million for Rialto's 40 percent equity interest and approximately $365 million for the FDIC's 60 percent equity investment. Rather than 8 cents on the dollar, it is more accurate to say that Rialto paid approximately 24.3 cents on 60.8 cents for its 40 percent share of the two LLCs.

In summary, Rialto paid market value for its interest in these loans in a highly competitive sale that is expected to achieve returns well in excess of those the FDIC would have achieved from an immediate cash sale of the loans. While the transaction initially realized an implied value for the portfolio of 40.5 percent of the UPB, the ultimate recovery will be determined over time based on the LLCs recovery on the loans.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

June 26, 2012

Honorable Maxine Waters
House of Representatives
Washington, D.C. 20515

Dear Congresswoman Waters:

This letter is in response to your request for information during the testimony of Bret Edwards, Director, Division of Resolutions and Receiverships, on May 16, 2012, at the hearing entitled "Oversight of the Structured Transaction Program" before the Subcommittee on Oversight and Investigations of the House Financial Services Committee.

At the hearing you asked for information on the participation of minority- and women-owned businesses in the structured transaction and related programs. Enclosed is a report prepared by the Federal Deposit Insurance Corporation's Division of Resolutions and Receiverships that provides the information you requested.

We hope that this information is helpful. If you have further questions, please do not hesitate to contact me at 202-898-8730, or Ike Jones, Legislative Attorney and Advisor, at 202-898-3657.

Sincerely,

(b)(6)

Alice C. Goodman
Acting Director
Office of Legislative Affairs

Enclosure

cc: Honorable Randy Neugebauer
Chairman, Subcommittee on Oversight and Investigations

Honorable Michael E. Capuano
Ranking Member, Subcommittee on Oversight and Investigations

Response to questions from the Honorable Maxine Waters
by Bret Edwards, Director, Division of Resolutions and Receiverships
Federal Deposit Insurance Corporation

Participation of Minority- and Women-Owned Businesses in the FDIC's Structured Transaction Program

Investor Pre-Qualification:

General Prospective Bidder Pre-Qualification

The FDIC initiated the structured transaction sales program in May 2008 and has entered into 32 LLC transactions to date. Structured sales transactions are marketed only to individuals and companies that can attest to a minimum net worth and institutional investors that meet the definition of bank, savings and loan association, or other institution as defined by the Securities Act of 1933, broker dealers under the Securities Exchange Act of 1934, and investment companies, business development companies or private business development companies as defined by the Investment Company Act of 1940 or the Investment Advisors Act of 1940, as applicable. In addition, prospective investors must attest, represent, and warrant to additional criteria including their ability to evaluate and bear the risk associated with such transactions and also sign the Purchaser Eligibility Certification. If an entity attests to these requirements, contact information for the entity is sent to the financial advisor retained by the FDIC to conduct the sale.

As of May 31, 2012, 713 prospective bidders have been pre-qualified to receive information on security sales, including structured sales transactions. One hundred twenty-two minority- and women-owned (MWO) firms have been pre-qualified comprising 17 percent of the pre-qualified investors.

May 31, 2012	Minority and Women Owned Prospective Investor Summary	
Race/Ethnicity	**Gender**	**No. of**
American Indian or Alaskan Native	M	1
	F	2
	Subtotal	**3**
Asian	M	25
	F	6
	Subtotal	**31**
Black or African American	M	27
	F	7
	Subtotal	**34**
Native Hawaiian or Other Pacific Islander:	M	0
	F	0
	Subtotal	**0**
Hispanic/Latino	M	16
	F	4
	Subtotal	**20**

Woman or Entity Woman Owned	Y N	33 0
	Subtotal	**33**
Claimed Minority **No Designation Provided**		1 0
Total MWOB Firms		**122**

Transaction Specific Qualification

All prospective bidders wishing to bid on a specific transaction, after performing due diligence, must be approved by the FDIC to bid on the transaction. In order to be approved, the prospective bidder must demonstrate adequate capital to close the transaction and have the ability to manage and service the assets in the structure. In many cases, bidders form consortia or ventures comprised of several capital investors together with firms that have the necessary skill sets to manage and dispose of the assets in the transaction. The complexity of the transactions and need for multiple sources of capital and expertise create opportunities for firms to create ventures to bid on the transactions.

Tracking MWO Participation in Structured Transactions – 2010:

Early transactions did not ask prospective investors to provide information on their status as a minority- or woman-owned business (MWOB). Beginning in May 2010, the FDIC's Division of Resolutions and Receiverships (DRR) began reporting on the status of MWOB participation for individual transactions at key decision points: bidder qualification, bid submissions, and successful bids. In September 2010, DRR also began to collect MWOB information from investors, asset managers, and servicers pre-qualifying with DRR to receive announcements about upcoming structured transactions.

In response to investor feedback on the prior transactions, in late 2010 the FDIC announced that it would offer structured sales transactions with loan pools that were more geographically focused and had smaller aggregate values than prior transactions. In fulfillment of this announcement, the FDIC created the Small Investor Program (SIP) Pilot Sale with loans of equal or better quality than the loans previously included in the multibank structured loan sales to increase the opportunity for participation by diverse bidders or consortia of bidders.

Structured Sales Program Awareness:

During 2010 and early 2011, FDIC conducted outreach workshops for minority- and women-owned businesses and investors to educate firms on how to do business with FDIC and explore available opportunities. FDIC held eight workshops throughout the country. The FDIC sent out 5,300 invitations that resulted in 887 RSVPs and 615 attendees at the workshops. The programs were designed to accurately reflect opportunities for contracting and participation in asset sales at the FDIC, including the SIP Pilot Program. Prior to the SIP sale, DRR and the FDIC's Office of Minority and Women Inclusion (OMWI) included information about the SIP pilot program in the workshops to give prospective investors, asset managers, and servicers more time and information to form investor groups capable of bidding on the sales.

In addition to the workshops, DRR and OMWI follow-up regularly with MWOBs on an individual basis and attend conferences to help MWOBs, many of whom are smaller investors, understand the FDIC's programs.

Investor Match Program – September 2011:

As a result of feedback from the workshops, the FDIC launched the Investor Match Program (IMP) in September 2011 to encourage all firms interested in bidding on FDIC asset sales programs, especially minority and women-owned businesses, the ability to share information on their companies with other like-minded firms. The IMP is based on an automated platform that allows companies to network with each other so firms may form ventures to bid on FDIC asset sales programs. The FDIC benefits from use of the program by allowing investors, asset managers, and servicers the ability to communicate with each other in an effort to more effectively compete in structured sales transactions. As of May 31, 2011, 176 pre-qualified investors have registered to use IMP and 60 of the investors (34 percent of the users) are MWOBs.

Minority and Women-Owned Participation in Structured Sales Transactions Transactional Overview - 2010 – 2011:

The following information reviews the participation of MWO entities in Structured Transactions in 2010 and 2011. Winning bidder teams that include a MWO component regardless of size are identified, along with the MWO category and the role in the investment team. It is important to note that the following information tracks marketing efforts for all structured sale transactions since April 2010. In certain cases, FDIC chose to award the sale on a cash basis when both cash and structured sales options were offered. In other cases, pools were allowed to be consolidated into one LLC when the same investor was the successful bidder on multiple pools.

2010

- Of 13 structured sale auctions from April 2010 through December 2010, minority and women-owned businesses participated in 38 of 146 (26 percent) applications, 21 of 71 (30 percent) bids, and 7 of 13[1] (54 percent) winning bids.
- Of the 7 winning bids, 4 include minority investors, 2 include minority asset managers, and 1 includes a combination of minority- and woman-owned businesses as both lead bidder and asset manager.

Group	Applications*	Bids Submitted	Winning Bids
Minority	26	15	6
Women	12	6	1**
Total Minority & Women	38	21	7
Non-MWOB	108	50	6
Total	146	71	13

* Only counts an application once even though a bidder may qualify and bid multiple times.

** Represents a combination minority and woman-owned business participation.

[1] Structured Transaction Sales may have no winning bids or multiple winning bids.

Winning MWO Bidders:

Transaction	Winning Bidder	MWO Category	Role
2010-CRE-1	Colony Capital	Black or African American Male	Investor
2010-CADC-1	Mariner RE Partners	American Indian or Alaskan Native Male	Asset Manager
2010-RADC-1	Mariner RE Partners	American Indian or Alaskan Native Male	Asset Manager
2010-CRE-2 (SE Pool)	Hudson	Asian Female	Lead Bidder, Asset Manager
2010-CRE-2 (W Pool)	Colony Capital	Black or African American Male	Investor
2010-CRE-2 (N Pool)	Colony Capital	Black or African American Male	Investor
2010-C/RADC-2	Colony Capital	Black or African American Male	Investor

2011

DRR completed nine competitive marketing efforts for structured transactions which had bid dates in 2011 (2011-SIP-2 closed in January 2012). Statistics from these auctions follow:

- Of 9 structured sale auctions during 2011, minority and women-owned businesses participated in 33 of 102 (32 percent) applications, 25 of 66 (38 percent) bids, and 5 of 10 (50 percent) winning bids.
- Of the 5 winning bids, 3 include minority investors, 1 includes a minority as both lead bidder and asset manager, and 1 includes a combination of minority- and woman-owned business as both lead bidder and asset manager.

Group	Applications*	Bids Submitted	Winning Bids
Minority	17	13	4
Women	16	12	1**
Total Minority & Women	33	25	5
Non-MWOB	69	41	5
Total	102	66	10

* Only counts an application once even though a bidder may qualify and bid multiple times.

** Represents a combination minority and woman–owned business participation.

Winning MWO Bidders:

Transaction	Winning Bidder	MWO Category	Role
2011-SIP-1 (CRE, CADC)	Acorn (Oaktree)	American Indian or Alaskan Native Male	Investor
2011-SIP-1 (RADC)	Hudson	Asian Female	Lead Bidder, Asset Manager
2011-ADC-1	Acorn (Oaktree)	American Indian or Alaskan Native Male	Investor
2011-ADC-2	Oaktree Capital	American Indian or Alaskan Native Male	Investor
2011-SIP-2	Mariner	American Indian or Alaskan Native Male	Lead Bidder, Asset Manager

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

July 13, 2012

Honorable Spencer Bachus
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to respond to the questions submitted by Congressman Bill Posey subsequent to testimony by Richard Osterman, the Federal Deposit Insurance Corporation's Acting General Counsel, at the hearing on "Examining the Settlement Practices of U.S. Financial Regulators" before the Committee on Financial Services on May 17, 2012.

Enclosed are Mr. Osterman's responses. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to questions from the Honorable Bill Posey
by the Federal Deposit Insurance Corporation

Please provide the following data on your agency's settlement practices. Should your agency lack the authority to pursue criminal prosecutions, please tell me what referrals related to the questions posed your agency has given to the Department of Justice and the outcome of those referrals.

Q1: Number of criminal prosecutions pursued
Q2: Number of convictions arising from those prosecutions

A1&2: As you are aware, banks and their institution-affiliated parties who violate federal or state criminal statutes can be prosecuted by the United States Department of Justice (DOJ) or criminal prosecutors in the various states. The FDIC has no authority to pursue criminal prosecutions against banks and bankers, but it does play an important role in ensuring that information about suspected crimes is brought to the attention of criminal prosecutors, as do other federal and state regulators.

The FDIC has promulgated a regulation, 12 C.F.R. Part 353, that requires an insured state nonmember bank to file a Suspicious Activity Report (SAR) when the bank detects a known or suspected criminal violation of federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act. SARs are filed with the Financial Crimes Enforcement Network (FinCEN) of the United States Department of Treasury. When FDIC examiners discover suspicious activity and the bank has not filed a SAR, the FDIC will file a SAR with FinCEN. The FDIC 2011 Annual Report indicates that for the years 2009, 2010, and 2011, a total of 128,973, 126,098, and 125,460 SARs, respectively, were filed regarding open and closed FDIC supervised insured depository institutions. Of this total of 380,531 SARs filed, 301 were filed by the FDIC and the rest by banks the FDIC supervises. Law enforcement SAR review teams, made up of DOJ attorneys and agents from the Federal Bureau of Investigation, access and analyze the data collected by FinCEN for purposes of pursuing criminal investigations and possible criminal prosecutions and refer cases for prosecution to the appropriate United States Attorney.

While SARs are a critical tool in detecting and prosecuting crimes against financial institutions, they are only reports of suspected criminal activity, not evidence of a crime. Prosecutors at DOJ must decide whether to prosecute based on the facts, seriousness of the alleged crime, and available resources. Thus, while many SARs result in criminal prosecutions and convictions, many do not. While prosecutors may communicate informally with the FDIC in individual cases, any comprehensive statistics regarding prosecutions and convictions would have to come directly from DOJ.

The Office of Investigations of the FDIC's Office of Inspector General (OIG) works closely with the supervisory side of the FDIC to identify and investigate financial institution crime, especially various types of fraud. The OIG works cooperatively with U.S. Attorneys throughout the country and those efforts have resulted in the prosecution of numerous individuals for financial

institution fraud and mortgage fraud schemes. Highlights of the cases pursued by the OIG are detailed in its semiannual reports to Congress, which can be found on its website www.fdicig.gov under the "Publications" tab. In addition, the following is a summary of the volume and outcome of Office of Investigations' cases during and following the most recent banking crisis.

Office of Investigations Open/Closed Cases Statistics

	Fiscal Year ending 9/30				
	2008	2009	2010	2011	2012*
Total Cases Opened	79	83	79	75	36
Open Banks	41	33	23	36	25
Closed Banks	26	36	43	30	10
Total Cases Closed	53	48	38	52	34
Judicial Actions					
Indictments/Informations	123	137	169	184	53
Bank Officers/Directors	*11*	*17*	*17*	*23*	*5*
Convictions	103	100	109	168	46
Bank Officers/Directors	*14*	*14*	*8*	*25*	*5*
Arrests	44	84	98	112	27

*First half of FY 2012, ending 3/31/12

Additional information regarding these investigative activities can be obtained from the FDIC Inspector General at (703) 562-2166.

Q3: Number and amount of stipulated settlements (and the total amount of damages to which the settlement pertains

A3: As FDIC witness, Richard Osterman noted in his May 17 testimony, with regard to open banks, most enforcement orders are issued based upon a stipulation with the respondent. From 2007 through 2011, the FDIC issued approximately 1,000 Cease-and-Desist Orders, 377 Prohibition Orders and 753 Civil Money Penalties (CMPs). To provide more detail on the CMPs assessed following the banking crisis of 2008, we reviewed all CMPs issued from 2009 through 2011. Excluding the CMPs assessed for inaccurate Home Mortgage Disclosure Act reporting and for Flood Disaster Protection Act violations, in 2009 the FDIC issued 33 CMPs with assessments totaling $1,371,500. In 2010, the FDIC issued 59 CMPs with assessments totaling $3,970,900. Finally, in 2011 the FDIC issued 49 CMPs with assessments totaling $14,566,500. With respect to consumer enforcement cases where there is evidence of significant consumer harm, the FDIC typically seeks restitution for the benefit of aggrieved consumers. During the period 2009 through 2011, the FDIC issued 14 restitution orders against banks. Collectively, those orders resulted in $65 million of restitution for consumers.

Q4: Number of compensation committees examined for impropriety

A4: While the FDIC incorporates review of executive compensation as a matter of course in every safety and soundness examination, most of the financial institutions supervised by the FDIC are smaller community banks that do not have dedicated compensation committees. For these smaller institutions, executive compensation generally is addressed by the bank's board of directors or perhaps by an executive committee of the board. In examining for executive compensation, where the level of compensation does not match the duties and responsibilities of the office or is inconsistent with peer group comparison, FDIC examiners will further investigate the situation. In most cases where compensation irregularities are discovered, the institution will voluntarily address and correct the situation. In rare cases, the FDIC has been forced to pursue formal enforcement actions such as Cease-and-Desist Orders requiring correction and reimbursement of excessive compensation previously paid.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

September 17, 2012

Honorable Tim Johnson
Chairman
United States Senate
Committee on Banking, Housing, and Urban Affairs
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to testify before the Committee at the June 6, 2012 hearing *Implementing Wall Street Reform: Enhancing Bank Supervision and Reducing Systemic Risk.*

Enclosed are my responses to the follow up questions you provided to complete the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Eric Spitler, Director of the Office of Legislative Affairs at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg
Acting Chairman

Enclosure

Response to questions from the Honorable Roger Wicker
by Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation

Section 165 of the Dodd-Frank Act requires certain nonbank financial companies and each bank holding company with total consolidated assets of $50 billion or more to periodically file a Resolution Plan, or "living will," for the company's resolution in the event of material financial distress or failure, and to report on the nature and extent of each company's credit exposures. In implementing this requirement, please explain:

Q1: Whether and to what extent the FDIC will compare Resolution Plans submitted by each institution to assess how many have identified the same issues in their plans and whether that might have systemic risk implications.

A1: The FDIC's plan review process is designed to include a 'horizontal review' of certain identified topics expected to be addressed by each institution. This horizontal review includes an analysis of the strategies of each institution put forward for its material entities, as well as the various resolution regimes (such as bankruptcy for holding companies, receiverships for insured depository institutions and administrations for foreign entities) under which the material entities will be required to be resolved, identified obstacles, related mitigants to those identified obstacles, and the assumptions upon which the institution relies to support the feasibility of those strategies.

This comparative review will help to focus on key systemic issues that have been raised in the industry domestically as well as globally. The review will include:

- interconnections and interdependencies such as cross company borrowing, lending, or shared services;
- the treatment and booking of derivatives, domestically and cross-border
- the impact of qualified financial contracts;
- the ability to separate and substitute core business lines and critical operations; and
- the reliance on common global payment systems and financial market utilities and infrastructures.

Additionally, the comparative review and assessment will help to identify gaps and areas that may require further regulatory consideration and guidance in order to strengthen the oversight of systemically important financial institutions.

Q2: To what extent regulators have ascertained the costs to the private sector of preparing Resolution Plans. (Has the FDIC considered asking each company to compile a cost of assembling such a plan?)

A2: Each of the companies that were required to submit plans by July 1, 2012, expended significant resources in developing their resolution plans, representative of the seriousness placed on these plans and the challenges associated with a first time reporting requirement. In addition to the dedication of internal staff resources, many of these initial companies, which included the largest and most complex financial institutions, also hired external legal, accounting, and general consulting firms to support their efforts. The FDIC has not asked each company to compile the total cost of assembling such plan. In conjunction with the 165(d) rulemaking, the FDIC developed some preliminary estimates of the hours that would likely be required to complete the initial plan submissions, which assumed an internal preliminary estimate of 9,200 hours for an initial full report by the largest institutions and approximately half that amount for others. Once baseline plans are established, we would anticipate the burden to be substantially less in future years. These estimates did not include the cost of systems upgrades and other investments that firms may make in order both to comply with the ongoing requirements and to better manage resolution risk.

Q3: Whether the FDIC intends to report to Congress or otherwise release any information about what the FDIC has learned as a result of receiving such information.

A3: Please see response to Question 2.

Q4: Whether the FDIC expects that its review of the initial Resolution Plans will form the basis of revising the requirement for the institutions required to file by July 1, 2013.

A4: Yes, we expect that the FDIC and the Federal Reserve Board (FRB) will provide further guidance to those institutions that are required to submit initial plans by July 1, 2013, that will be informed by our review of the first submissions. These initial plans will inform the FDIC and FRB as to whether the guidance provided to the firms needs further clarification, and which assumptions provided to the firms should be modified. Through a comparative review of the plans, we expect to identify the approaches which best address the intent of the resolution plan requirement and facilitate FDIC and FRB review.

We also anticipate that guidance for those institutions required to file by July 1, 2013, may be modified beginning in the fourth quarter of 2012 because of the nature of those firms relative to the initial filers, which included some of the largest and most complex financial institutions.

Q5: With respect to the FDIC's stated intention to resolve a failing financial institution by placing the top-tier holding company into the orderly liquidation authority and continuing to operate all of the subsidiaries, how, if at all, this approach should affect the content or direction of a Resolution Plan.

A5: The "Living Wills" are the firms' plans to resolve themselves under the U.S. Bankruptcy Code and therefore the plans should not be affected by the FDIC's strategies for resolving the firms under Title II of the Dodd-Frank Act.

Q6: Whether the FDIC intends to report to Congress or otherwise release any information about what the FDIC has learned as a result of reviewing Resolution Plans.

A6: The public portion of the plans are currently available to the public on our website and have been the subject of considerable analyst comment.

Q7: Whether Resolution Plans will be used in enforcement actions.

A7: The Resolution Plans are not being sought for the purpose of developing or supporting an enforcement action. If, however, a situation arises in which a Resolution Plan (or a portion of it) would constitute relevant evidence in an enforcement action, there is no prohibition on the FDIC or another appropriate federal regulator using it for that purpose.

Q8: While the Dodd-Frank Act does not appear to require that an institution make any part of its Resolution Plan public, federal regulations seem to permit an institution to prepare a public section (with the institution exercising its own judgment about what information is proprietary and should not be disclosed). Does the FDIC plan to second-guess those judgments? Does it plan to issue any further guidance about the content of the public section?

A8: 12 CFR Part 381.8(c) sets forth the required elements of the public section of a resolution plan filed pursuant to section 165(d) of the Dodd-Frank Act. The FDIC intends to review the public section of each resolution plan for compliance with this subsection of the regulation. Based on this review, the FDIC's Office of Complex Financial Institutions may add to or amend one or more of the required elements. However, there are no specific plans to do so at this time.

Q9: With regard to the confidential portion of a Resolution Plan, will the FDIC accord it the same degree of confidentiality that it accords reports of examination? If not, why not, and what degree of confidentiality would the FDIC extend to such information? How widely will the FDIC share a Resolution Plan with other banking regulators?

A9: Yes, the FDIC will provide the Resolution Plans with the same level of confidentiality as accorded to reports of examination. Section 112(d)(5)(A) of the Dodd-Frank Act (18 U.S.C. §5322(d)(5)(A)) requires the Federal Reserve Board and the FDIC to maintain the confidentiality of any data, information, and reports submitted under Title I (including the resolution plans prepared and submitted as required under section 165(d) of the Dodd-Frank Act), and the FDIC fully intends to comply with that legal requirement. The FDIC has implemented security practices for the plans to ensure that we maintain their confidentiality consistent with applicable exemptions under the Freedom of Information Act (5 U.S.C. 552(b)) and the FDIC's Disclosure of Information Rules (12 CFR part 309).

The FDIC will share the resolution plans with other banking regulators to the extent permitted by law.

Response to questions from the Honorable Pat Toomey
by Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation

When Congress passed the Volcker Rule provisions of the Dodd-Frank Act, Congress intended to give regulators the authority to exclude venture capital funds from the definition of "covered funds." In a recent study, the FSOC recommended "that Agencies carefully evaluate the range of funds and other legal vehicles that rely on the exclusions contained in section 3(c)(1) or 3(c)(7) and consider whether it is appropriate to narrow the statutory definition by rule in some cases."

Q1. Do you agree that you have the authority and discretion to exclude venture capital funds from the definition of "covered funds?"

Q2. Do you agree that sound venture capital investments lead to job creation and economic growth?

A1 & 2: Section 619(h)(2) of the Dodd-Frank Act defines the terms "hedge fund" and "private equity fund" as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940 (15 U.S.C. 80a–1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine." This definition, as written, would cover the majority of venture capital funds.

As part of the Notice of Proposed Rulemaking (NPR), the agencies sought public comment on whether venture capital funds should be excluded from the definition of "hedge fund" and "private equity fund" for purposes of the Volcker Rule. In Question 310 in the NPR, the agencies ask:

> Should venture capital funds be excluded from the definition of "covered fund"? Why or why not? If so, should the definition contained in rule 203(*l*)-(1) under the [Investment] Advisers Act be used? Should any modifications to that definition of venture capital fund be made? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the [Bank Holding Company Act]?

Sound venture capital investments, like other investment activities, can contribute to job creation and economic growth. In conjunction with the development of the final rule, the agencies are reviewing public comments responding to the NPR, including comments on Question 310 related to venture capital funds. The agencies will take these and all comments into consideration in the development of the final rule.

Response to Questions from the Honorable David Vitter
By Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: On December 31st, Section 343 of the Dodd-Frank Act, addressing unlimited FDIC-insurance coverage for non-interest bearing transaction accounts, is scheduled to sunset. As you know this section was based upon the FDIC's Transaction Account Guarantee Program. Whether or not TAG is extended through the end of the year, it is clear that this type of supernatural government involvement cannot be maintained indefinitely. Can you advise the Committee whether any alternatives exist, or which are under consideration by the FDIC, that would instill the confidence our small businesses and our local governments need to avoid having to pull payroll or transaction accounts from their local community banks since each Friday it seems that these folks read about some local bank being put on the FDIC's receiverships list?

Q2: What precisely has the FDIC done to foster the development of private sector solutions to TAG?

A1&2: From the FDIC's standpoint, the most effective action that bank regulatory agencies can take to maintain the confidence of small business and local government depositors in their community banks is to ensure that these banks strengthen their capital and liquidity positions. To the great credit of community banks, with the encouragement of bank examiners, they have significantly strengthened their capital and liquidity over the past several years. As of June 2012, the average leverage capital ratio for banks with less than $1 billion in assets was 10.3 percent, almost exactly what it was at the end of 2007, when it was 10.4 percent, and more than it was at the end of 2002, when it was 9.6 percent. As of June 2012 the average ratio of short-term assets to short-term liabilities for commercial banks with less than $1 billion in assets was 105.7 percent, compared to 84.7 percent at the end of 2007 and 86.7 percent at the end of 2002. These actions by community banks to increase their capital and liquidity are, in fact, a strong private sector response to the issue of maintaining confidence.

Response to questions from the Honorable Sherrod Brown
by Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation

During the June 6th hearing, Mr. Gruenberg agreed that "historically, including to the present day, the biggest risk of banking is the lending activity that is inherent to the banking process."

In testimony before the Subcommittee on Financial Institutions and Consumer Protection on May 9th, the former Chief Economist of the Senate Committee on Banking, Housing, and Urban Affairs stated:

> "In a remarkably understated 2007 annual inspection report on Citigroup, the Federal Reserve Bank of New York observed that '[m]anagement did not properly identify and assess its subprime risk in the CDO trading books, leading to significant losses. Serious deficiencies in risk management and controls were identified in the management of Super Senior CDO positions and other subprime-related traded credit products.' By the end of 2008 Citigroup had written off $38.8 billion related to these positions and to ABS and CDO securities it held in anticipation of constructing additional CDOs."

Testimony of Marc Jarsulic, Chief Economist, Better Markets, Inc., before the Senate Committee on Banking Housing and Urban Affairs Subcommittee on Financial Institutions and Consumer Protection, "Is Simpler Better? Limiting Federal Support for Financial Institutions" 9, May 9, 2012.

According to accounts of the hearings held by the Financial Crisis Inquiry Commission, two witnesses agreed that CDOs were responsible for Citigroup's financial difficulties:

> "[Former Citigroup chief executive Charles] Prince ultimately blamed much of Citi's problems on CDOs, which he said were complex and entirely misunderstood. He said the company, its risk officers, regulators and credit rating agencies believed CDOs were low-risk activities. As it turned out, they resulted in $30 billion worth of losses...
>
> "[Former Comptroller of the Currency John] Dugan, too, put much of the blame on CDOs, partly as a way of defending his own agency. He said the bank, which the Office of the Comptroller of the Currency oversaw, did not damage the holding company, while Citi's securities broker-dealers, which managed the CDOs and were overseen by the Securities and Exchange Commission, were at fault.
>
> 'The overwhelming majority of Citi's mortgage problems did not arise from mortgages originated by Citibank,' Dugan said. 'Instead, the huge mortgage losses arose primarily from the collateralized debt obligations structured by Citigroup's securities broker-dealer with mortgages purchased from third parties.'"

Cheyenne Hopkins, *No One Was Sleeping as Citi Slipped*, AM. BANKER, Apr. 8, 2010.

Q1: Do you agree with the New York Fed, the former Comptroller of the Currency, the former Chief Economist of the Senate Banking Committee, and the former CEO of Citigroup that CDOs were a substantial cause of Citigroup's financial difficulties in 2008, resulting in significant support from the federal government, including capital injections from the Treasury Department, debt guarantees from the FDIC, and loans from the Federal Reserve?

A1: Without getting into the specifics with respect to Citigroup, I agree that CDOs and other model-driven, structured products played a substantial role in the most recent crisis. Many banks viewed the creation of these products as a means to fund lending activities and shift credit risk off balance sheet. Unfortunately, as these products continued to develop, they resulted in untenable concentrations of systemic risk and leverage in products that, by their very nature, lacked transparency. The popularity of these instruments as investment vehicles increased dramatically as the senior-most tranches received the highest investment-grade ratings, and their coupon rates dramatically exceeded the steadily declining Federal Funds and U.S. Treasury rates. The high investor demand for CDOs placed considerable stress on banks and non-bank mortgage brokers to underwrite the significant volume of mortgages that ultimately backed the CDOs. This resulted in the weakening of underwriting standards and the issuance of poorer quality CDOs.

Response to questions from the Honorable Richard Shelby
by Martin J. Gruenberg, Acting Chairman
Federal Deposit Insurance Corporation

Q1: You testified today that small bankers have told the FDIC that compliance with the escrow account requirement in Dodd-Frank could be so costly as to be prohibitive, and that they would cease originating mortgage loans for their customers. What specific recommendations have you given the Bureau as it develops the final rule implementing the Dodd-Frank escrow requirements?

A1: As you know, the FDIC is the primary federal regulator for the nation's small community banks. My staff engages frequently with community banks in roundtables around the country to be certain that we understand how regulatory changes affect them and to listen to their concerns. We know that in many rural and underserved areas, community banks are the primary source to meet the financial services needs in those communities.

We understand that the Dodd-Frank Act's mandatory escrow accounts do not apply to all mortgage lending. The requirement does not apply to market-rate loans that are not insured by a government agency, unless state or federal law provides otherwise.[1] Additionally, the Dodd-Frank Act allows the Bureau to exempt banks and other lenders operating in rural or underserved areas from the escrow requirements.

Prior to the implementation of the CFPA (Consumer Financial Protection Act of 2010) and the Consumer Financial Protection Bureau's start-up date, the Federal Reserve Board issued a notice of proposed rulemaking that would amend the existing escrow rule to reflect the Dodd-Frank Act changes.[2] As of July 21, 2011, this proposal became a CFPB proposed rule.

The proposed rule contemplated an exemption for creditors in rural and underserved areas. We have shared with the CFPB the feedback we have received from community banks, particularly those in rural areas, regarding the banks' concerns about the impact of the proposed escrow rule, and we have suggested that the Bureau exempt from the escrow requirement all banks that operate predominantly in rural areas.

We will continue to explore options to improve the examination process for community banks while preserving the benefits of appropriate regulation that ultimately will serve the interest of lenders, consumers, and the economy as a whole. We will continue to offer to the Bureau the perspective we bring as a result of our commitment both to the health and continued vibrancy of small community banks and to the needs of the customers they serve.

Q2: Mr. Gruenberg, in a recent speech you said that the failure of a systemically important financial institution will likely have significant international operations and that

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[1] 15 U.S.C. 1639d(b)

[2] 76 Fed. Reg. 11598 (March 2, 2011), proposing amendments to Regulation Z, 12 C.F.R. 1026.35(b)(3).

this will create a number of challenges. What specific steps have been taken to improve the cross-border resolution of a SIFI?

A2: The following specific steps have been taken to improve the cross-border resolution of a SIFI:

- Identification of Priority Jurisdictions: The FDIC has conducted a series of "heat map" exercises with respect to the global footprint of U.S. SIFIs to identify the priority jurisdictions and regulators for cross-border coordination in connection with crisis management, recovery and resolution planning, and implementation. Based on the on-balance sheet and off-balance sheet information reported by each of the top eight U.S. SIFIs, the FDIC has identified 12 priority jurisdictions that are host to over 97 percent of the total reported foreign activities of the top U.S. SIFIs. Of these 12 jurisdictions, over 90 percent of the SIFIs' total reported foreign activities are in two jurisdictions, the United Kingdom and Ireland. The FDIC is conducting robust outreach in these priority jurisdictions.

  Jurisdictional Survey: In addition to these heat mapping exercises, the FDIC is conducting a survey on the legal and regulatory regimes in the priority jurisdictions. The survey assists us in identifying the obstacles to effective cross-border resolution and cooperation and the coordination measures we may take with fellow regulatory and resolution authorities to mitigate such obstacles.

- Participation in Crisis Management Group Meetings: Under the auspices of the Financial Stability Board, the FDIC and its U.S. and non-U.S. banking regulatory authority colleagues are working in Crisis Management Groups on recovery and resolution strategies for each of the global systemically important financial institutions identified by the G-20 at their November 4, 2011 meeting. The work of these Crisis Management Groups, consisting of both home and host authorities, is intended to enhance cross-border institution-specific planning and cooperation for a possible resolution, should it become necessary. The work also allows regulators to identify impediments to a more effective resolution based on the unique characteristics of a particular financial company and the jurisdictions in which it operates.

Q3: In your view, what additional steps must be taken with respect to the cross-border resolution of a SIFI?

A3: In our view, the following additional steps must be taken with respect to the cross-border resolution of a SIFI:

- Dialogues with foreign resolution counterparties must continue. Many jurisdictions are in the process of amending their resolution regimes and we are following these developments with great interest.

- As jurisdictions develop resolution strategies for their respective SIFIs, we must understand their impact on the U.S. operations.

- The FDIC is in the process of understanding the usage of financial market utilities by each SIFI and the impact of a SIFI's entry into Title II receivership on its membership and processing arrangements with financial market utilities.

- Through the review of the Title I resolution plans or "living wills" and enhanced heat mapping exercises, the FDIC will gain transparency on the location and usage of each SIFI's data and profit centers, as well as location where liquidity is concentrated.

- The FDIC is working with fellow regulators in determining the extent of information with respect to each SIFI that may be shared on a confidential basis with other resolution authorities in connection with our cross-border coordination efforts on crisis management, recovery and resolution planning, and implementation.

Response to questions from the Honorable Tim Johnson by Martin J. Gruenberg, Acting Chairman Federal Deposit Insurance Corporation

Q1: In recent testimony on the trading loss by JP Morgan Chase & Co. (JPMorgan), you stated that the FDIC's "discussions have also focused on the quality and consistency of the models used in the CIO as well as the approval and validation processes surrounding them." What have you learned about the quality and consistency of the models and the approval and validation processes at JPMorgan?

A1: The FDIC continues to work with both OCC and Federal Reserve staff to review the models used in JPMorgan Chase's CIO unit for the assessment of risk associated with that unit's credit hybrid's business. This review has focused on an assessment of the JPMorgan Chase's VaR methodology and the identification of any weaknesses in the firm's processes and procedures for model governance, validation, and controls. This evaluation is ongoing and the FDIC does not publicly disclose regulators' findings.

Q2: You have stated that your agency is in the process of internally reviewing the transactions, including identifying any "potential gaps within the firm's overall risk management." Mr. Curry has additionally stated that the Office of the Comptroller of the Currency (OCC) will be assessing how it can improve supervisory processes at the OCC. What gaps have you identified at the bank and as supervisors?

A2: Along with the OCC and the Federal Reserve, the FDIC continues its evaluation of the CIO portfolio, its governance structure, and the results of the work performed by JPMorgan Chase's internal investigation. The firm has identified major gaps in several areas within the CIO business line that contributed to the losses incurred. The primary areas of focus for the firm include the CIO trading strategy, VaR methodology and model governance, strength of risk management, and the CIO limit structure/escalation process.

Q3: You also stated in recent testimony, that the FDIC has added temporary staff to assist in its review. How many staff members have been hired, and do you have any updates on the FDIC's review?

A3: The FDIC has a permanent staff of four professionals onsite at JPMorgan Chase. Three additional FDIC staff members have been engaged to focus on the analysis of CIO related issues in addition to the analytical support of other FDIC examiners on an ad hoc basis.

Q4: At the Committee's hearing where Jamie Dimon, Chairman of the Board, President and Chief Executive Officer of JPMorgan testified, Mr. Dimon indicated that while the company has a compensation clawback policy in place, that authority has not been exercised. For the largest banks that benefit from the $250,000 deposit insurance

guarantee, are you aware of any bank exercising a clawback of compensation when major mistakes are made? Is it important for Boards of Directors of a large bank to utilize their clawback authority to deter other employees from making the same mistakes, and correct some of the misaligned pay incentives we saw leading up to the recent financial crisis?

A4: JPMorgan Chase announced during its second quarter earnings release that the firm intended to claw back compensation from CIO managers in London responsible for the CIO Synthetic Credit Portfolio. These employees were terminated without a severance or 2012 incentive compensation and the firm imposed the maximum claw back amount of two years of annual compensation. In one instance, an employee volunteered the claw back; and all claw back decisions were reviewed by JPMorgan Chase's Board of Directors. A firm's board of directors should be involved in the application of claw back provisions; and in the JPMorgan Chase situation, it appears that senior management took action without prompting from the Board.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

October 1, 2012

Honorable Spencer Baucus
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to testify before the Committee at the June 19, 2012 hearing "Examining Bank Supervision and Risk Management in Light of JPMorgan Chase's Trading Loss."

Enclosed are my responses to the follow up questions from you and Congressman Leutkemeyer to complete the hearing record.

If you have additional comments, please feel free to contact me at (202) 898-3888, or Eric Spitler, Director, Office of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg
Acting Chairman

Enclosures

Response to questions from the Honorable Spencer Baucus
by Martin J. Gruenberg, Acting Chairman,
Federal Deposit Insurance Corporation

Q1: Does the Dodd-Frank Act end "Too Big to Fail"? If so, why could former Kansas City Federal Reserve President and current FDIC Acting Vice Chairman Thomas Hoenig say in December 2010 that "the five largest financial institutions are 20 percent larger than they were before the crisis. They control $8.6 trillion in financial assets — the equivalent of nearly 60 percent of gross domestic product. Like it or not, these firms remain too big to fail?"

A1: The absence of effective alternatives to merging large, failing firms with other large financial organizations during a financial crisis created a system with more asset concentration and larger banking and other financial companies. In March 2007, the 10 largest insured depository institutions (IDIs) and their affiliates had about 49 percent of total IDI assets – this has grown to 52 percent today. Further, the four largest IDIs and their affiliates had about 38 percent of industry assets in 2007, as compared with 45 percent today.

The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) provides tools and powers that were not available during the crisis to end too-big-to-fail. Specifically, the Dodd-Frank Act:

- Requires large bank holding companies to prepare resolution plans or living wills that would allow for the orderly resolution of the company under the bankruptcy code; and
- Provides the FDIC new authority to place a bank, its holding company, and affiliates into an orderly resolution process if it is determined that the company cannot be resolved under the bankruptcy code without severe disruption to the financial system.

The FDIC will use these newly-available tools as necessary to ensure that the largest financial companies can successfully be resolved without significant adverse effects on the financial stability of the U.S.

Q2: Some have used JPMorgan's trading loss to argue that we should not permit insured depository institutions to engage in the kinds of activities that produced that loss, such as the purchase and sale of credit derivatives, on the grounds that such activity is "too risky." Yet there is also general consensus that the recent financial crisis was largely caused by poor underwriting of residential and commercial real estate loans – banks' "bread-and-butter" business – which suggests that focusing banks on their traditional lines of activity would not necessarily make them safer. Don't we need banks to take risks if we are going to have a dynamic market economy in which job creators can access the capital they need to establish and grow their businesses? In light of that, what do you make of calls to "de-risk" the banking system?

A2: As financial intermediaries, banks need to effectively manage risk to operate successfully and serve the needs of businesses and consumers. Banks support our economy with credit and depository services and play a critical role in the expansion of commercial enterprises that create jobs. Financial institutions facilitate economic growth and commerce by lending to creditworthy borrowers, providing payment systems and deposit services, and properly managing on- and off-balance sheet positions.

The federal banking supervisors have long supported strong risk management processes that enable financial institutions to better manage their organizations and mitigate unexpected losses. As you point out, myriad causes were behind the recent financial crisis. A central theme was the lack of effective risk management at many insured institutions and unregulated non-bank entities. Poor credit underwriting and outsized concentrations of real estate loans precipitated numerous bank failures and a rapid weakening of the economy and financial system generally. Furthermore, losses related to trading and hedging positions reinforced the need for careful risk taking, implementation of effective policies and exposure limits, strong controls and management information systems, and appropriate capital support. Since the crisis began, the FDIC has worked closely with banks to improve risk selection and management processes, address concentrations of risk, and strengthen earnings, capital, and liquidity.

In response to your question about "de-risking" the banking system, we believe that prudently controlled risk taking is an integral part of financial intermediation. Financial institutions, which are vital to our economy, should fully understand and control various exposures while minimizing undue concentrations that can cause significant losses. Regardless of an institution's size or business strategy, risk taking must be well managed within a robust policy and risk management framework that promotes safe-and-sound operation.

Q3: There is general agreement that our financial system was far too complex in the years leading up to the financial crisis, which led to risks being hidden from the view of the regulators and even from the boards of directors and management of the firms taking the risks. Yet the policy response to the crisis – the 2,300-page Dodd-Frank Act with its 400 new Federal regulations – has only made the system more complex and provided more opportunities for clever industry lawyers to game the system. Wasn't Dodd-Frank a missed opportunity to simplify our system and rationalize our financial regulatory structure? How would you recommend we go about creating a system that is less complex?

A3: The Dodd-Frank Act enacted reforms intended to address the causes of the recent financial crisis. Foremost among these reforms were measures to curb excessive risk taking at large, complex banks and non-bank financial companies where the crisis began. Title I of the Dodd-Frank Act includes new provisions that enhance prudential supervision and capital requirements for systemically important financial institutions (SIFIs), while Title II authorizes a new orderly liquidation authority that significantly enhances the ability to resolve a failed SIFI without contributing to additional financial market distress.

The FDIC is aware of concerns that the complexity of banking statutes and associated oversight processes are having an unintended effect on financial institutions.

The FDIC is committed to an effective regulatory process that is not needlessly complex and will support efforts to address the appropriateness of current requirements. As part of our implementation of the Dodd-Frank Act, we are updating, streamlining, or rescinding certain rules to comply with the statute. We also are sponsoring a Community Bank Initiative during 2012 to further our understanding of the challenges and opportunities for community banks and to review our examination and rulemaking process to ensure any unnecessary processes or requirements are eliminated. This will include an evaluation of our own risk-management and compliance supervision practices to determine if there are ways to make the process more efficient without sacrificing supervisory standards. We have engaged in a dialog with community bankers by holding a series of regional roundtables to solicit their input on these and other matters.

Further, we have taken steps to reduce complexity and increase transparency in rulemaking. In response to input from members of the FDIC's Advisory Committee on Community Banking on ways to streamline the regulatory process, we conducted a review of the materials that banks file with us and made changes to improve the process through greater use of technology and automation. Also, to make it easier for smaller institutions to understand the impact of new regulatory changes or guidance, we are now including a statement in our Financial Institution Letters (the communication that alerts banks to any regulatory changes or new guidance) as to whether the change applies to institutions with assets less than $1 billion.

Finally, the FDIC will perform a comprehensive review of its regulations to identify any outdated, unnecessary, or unduly burdensome regulations pursuant to the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). This well-established process requires the FDIC to conduct a complete review of our regulations at least once every ten years. To prepare for the upcoming EGRPRA review, the FDIC published for public comment, earlier this year, a plan outlining this process.

Q4: It is my understanding that the FDIC has been working with JPMorgan's primary federal regulators, the OCC and the Fed, as well as the institution itself, to investigate both the circumstances that led to the losses and the institution's ongoing efforts to manage the risks at the firm. What have you discovered so far?

A4: Along with the Comptroller of the Currency and the Federal Reserve Board, the FDIC continues its evaluation of the CIO portfolio, its governance structure and the results of the work performed as part of JPMorgan's internal investigation. Further, the FDIC continues to work with both OCC and Federal Reserve staff to review the models used in JPMorgan's CIO unit for the assessment of risk associated with that unit's credit hybrid business. This review has focused on an assessment of JPMorgan's value at risk (VaR) methodology and the identification of any weaknesses in the firm's processes and procedures for model governance, validation, and controls.

The firm has identified major gaps in several areas within the CIO business line that contributed to the losses incurred. The primary areas of focus for the firm include the CIO trading strategy, VaR methodology and model governance, strength of risk management, and the CIO limit

structure/escalation process. While the FDIC has been focused on a variety of issues and risk areas, we cannot publicly disclose supervisory findings.

Q5: Basel III's new capital requirements will make banks less profitable, and we have discovered – thanks to the law of unintended consequences – that any time government tries to thwart profitable enterprises, profitable enterprises find new ways to make money. Does Basel III encourage banks to make up lost profits by chasing riskier, more speculative activities? By encouraging them to raise the fees they charge individual consumers? Small business? Large firms? Who ultimately pays the price for Basel III – the big banks, or the American consumer?

A5: The new capital requirements reflect lessons learned during the recent financial crisis and improve and strengthen the overall quality and quantity of capital. This builds additional capacity into the banking system to absorb losses in times of economic and financial stress.

We do not believe that Basel III would encourage banks to engage in excessive risk taking. The core of the agencies' Notice of Proposed Rulemaking to implement Basel III is to increase the overall minimum requirements for the quality and quantity of bank capital. Over 90 percent of banks already meet the proposed standards even if they were put in place immediately (the NPR proposes a multi-year phase-in of the standards).

With respect to the costs of Basel III, the Financial Stability Board and the Basel Committee on Banking Supervision undertook studies of the potential economic impact of transitioning to the proposed new capital requirements. The studies concluded there would be considerable economic benefits from stronger capital requirements. The reason for this conclusion is that banking and financial crises have had significant negative effects on economic growth. By reducing the frequency and severity of banking crises, the new capital standards should make economic growth higher and more sustainable over time.

Q6: Can you explain how higher capital requirements would have guarded against some of the spectacularly bad decisions that led to the financial crisis? Would higher capital requirements have mitigated or blunted government housing goals, which put people in houses they couldn't afford? Would higher capital requirements have prevented Lehman from doubling down on a housing market that was about to collapse? In other words, are higher capital requirements a cure for bad business decisions?

A6: Capital requirements, by themselves, are not a sufficient safeguard against speculative behavior and poor decision making. Capital is, however, the shock absorber that allows banks to absorb losses and continue to act as financial intermediaries during periods of financial stress. Adequate bank capital promotes a stronger and more resilient financial system and protects the FDIC Deposit Insurance Fund from loss, minimizing the likelihood that the banking industry's premiums will need to be raised and, ultimately, the federal full faith and credit guarantee of insured deposits would need to be exercised.

Response to questions from the Honorable Blaine Leutkemeyer by Martin J. Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation

Q1: Are you making any recommendations on investing in European government bonds?

A1: The federal bank regulatory agencies do not make investment recommendations. However, the agencies have issued investment permissibility regulations and guidance articulating the expectation that appropriate due diligence should be performed on the suitability of individual investments before purchase. Under the investment permissibility regulations, foreign sovereign debt must meet certain requirements before a bank is permitted to invest. For example, the debt instruments should be marketable obligations that are not predominantly speculative in nature. Furthermore, as a result of statutory lending limits, banks are subject to limitations on the investment that they can make in the securities of any one foreign government. For example, a National Bank must limit the investment in the securities of any one foreign government to no more than 10 percent of that National Bank's capital and surplus. The laws of most states contain similar limits.

Q2: Are you classifying investments in European government bonds?

A2: Overall, U.S. banks are not large buyers of European government bonds. Additionally, European government bonds held for trading are marked-to-market daily and, as such, are not classified. To the extent U.S. banks hold European government bonds for investment purposes, classification decisions are made on a case-by-case basis. If a particular European country misses payments or defaults, the bonds would be classified based on our classification standards.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

December 21, 2012

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter enclosing questions subsequent to testimony by George French, Deputy Director of Policy, Division of Risk Management Supervision, at the Committee's November 14, 2012 hearing "Oversight of Basel III: Impact of Proposed Capital Rules."

Enclosed are our responses. If we can provide further information, please let us know. The Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to questions from the Honorable Mark Warner by George French, Deputy Director of Policy, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1: I, and many other Members, have brought up concerns about the need to tailor rules to the size and type of entity. However, I recognize the U.S.'s leadership role on the Basel Committee, and the need to move through this period of regulatory uncertainty so that businesses can make investment decisions. How can the Committee provide regulated entities more certainty about the timeline of rules being re-proposed or finalized in the future?

A1: Basel Committee capital standards are not legally binding, and implementing any Basel Committee standard is ultimately a matter of national discretion. The federal banking agencies have chosen to apply many Basel standards to large banking organizations, in part to promote internationally consistent regulatory capital standards. The banking agencies have not proposed to apply a number of important Basel standards to small banks. Basel II, Basel II.5 and important parts of Basel III, for example, do not apply to small U.S. banks. However, the agencies have proposed to apply the aspects of Basel III dealing with the definition and level of capital to all banks, along with aspects of the so-called Basel II Standardized Approach.

In considering changes to regulatory capital requirements, it is incumbent on the federal banking agencies to make the process as transparent and understandable as possible, including reducing uncertainty about timelines to the extent we can. In the case of the Basel III and Standardized Approach proposed rules, the FDIC engaged in an intensive technical assistance effort to help small banks understand the proposals and identify aspects that are of concern to them. This included providing detailed but concise summaries of the proposed rules, conducting a series of regional outreach meetings and a national call-in, posting a video describing each rule on our website, and working with other agencies to post a capital estimation tool on our respective websites.

With regard to timelines, the Basel III NPR proposed a multi-year phase-in period that extends as far as ten years in the future for some aspects of the proposals. The phase-in period was proposed to begin January 1, 2013. In light of the large volume of comments received, the agencies have clarified that the proposed rules will not take effect on January 1, 2013. We are working expeditiously to finalize the rulemaking process and will pay close attention to the need to provide adequate time for institutions to comply with a final rule.

These NPRs provide an example where the proposed timeline was much less important than the need for careful deliberation about the issues raised by commenters. We nevertheless agree with your comment about the importance of minimizing uncertainty to the extent possible in the rulemaking process, including rulemaking processes that are proposing to implement Basel Committee capital standards.

Q2. I've heard concerns that the proposed rules require unrealized gains and losses on available for sale assets to be recognized within AOCI. Insurers that are Savings & Loan Holding Companies are especially apprehensive about managing increased asset-liability mismatches. Can you discuss your broader goals to encourage a long-term focus in capital management, and address these AOCI concerns?

A2: The Basel III NPR seeks comment on the proposed treatment of unrealized gains and losses on available-for-sale (AFS) debt securities. Specifically, the proposal seeks comments on the potential volatility of capital that could arise from the proposed treatment as well as the effects this potential volatility could have on the ability of institutions to manage liquidity and their investment portfolios. We recognize that some volatility in accumulated other comprehensive income (AOCI) occurs purely due to changing interest rates, as opposed to changing credit quality, and the NPR seeks comment on an alternative treatment for those instruments – like U.S. government securities – that have market risk but little to no credit risk.

Among the broader policy goals is to ensure the components of regulatory capital are available to absorb losses during a period of stress. In general, AOCI represents the difference between the book value and the market value of the AFS securities. As such, if an institution needed to sell securities from its AFS portfolio to absorb losses, the amount the institution would realize would be only the market value.

Q3: We've seen some recent sales of MSRs from banks to non-banks since the proposal was released saying that MSRs may only be counted for up to 10% of CET1, and additional MSR holdings will be weighted at 250%. This is a significant change from allowing MSRs to be counted up to the equivalent of 100% of Tier 1 capital. The MSRs change comes in combination with more sophisticated risk-weights for mortgages that will require more capital for non-standard and high LTV mortgages. We also have QM and QRM on the way, which will have distinct definitions from Basel rules. I am supportive of a more nuanced approach to holding capital for mortgages, but is the panel concerned that the limited overlap in these regulations could cause much greater compliance difficulty for small institutions and negatively affect access to credit among low-to-middle income borrowers?

A3: We share your concern about the need to coordinate regulations to ensure harmonization. Many of the comments we received have expressed concern about the proposed residential mortgage risk weights, including the overlap with other mortgage regulations. Therefore, we continue to carefully evaluate the relationship of the Basel III NPR and the Standardized Approach NPR with other rulemakings, including QM and QRM. For instance, the Standardized Approach NPR specifically requested comment on the appropriate interaction between the mortgage risk-weight proposals and the QM and QRM rulemakings.

Q4. Trade finance transactions rely on letters of credit and other off-balance sheet items, and lenders will have to set aside 100% capital for these items if current proposals are implemented. This transition requires 5 times more capital compared to Basel II. Do you believe that these changes are likely to affect smaller companies and emerging countries to

a much greater extent? Can you respond to concerns that these proposals, as they are written, could constrict trade finance opportunities?

A4: The supplementary leverage ratio, which is applicable only to the largest banking organizations with total consolidated assets of $250 billion or more, would require such banks to capitalize for off-balance sheet items, using a 100 percent credit conversion factor. This is not the same as a 100 percent capital requirement as the credit conversion factor is then multiplied by a minimum capital requirement of three percent. As such, large banking organizations would be required to hold three percent capital for letters of credit and other off-balance sheet items under the supplementary leverage ratio. Although we will continue to evaluate these comments, we would not expect a three percent capital requirement to materially affect trade finance opportunities.

Response to questions from the Honorable Robert Menendez
by George French, Deputy Director of Policy, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1: A fundamental objective of Dodd Frank was to reduce systemic risk. I am concerned that the Fed's Basel III proposal could result in bank clearing members having to hold significantly more capital when their customers use less-risky instruments. Some argue that this incentive will make it more expensive to use exchange-traded futures than bespoke swaps. Should the rule be designed to encourage the use of lower risk profile products, rather than potentially discourage it?

A1: We recognize that the capital charge for exposures to exchanges has risen from zero under Basel II to a 2 percent risk weight under the proposed rule. However, notwithstanding this increase, the proposed rules continue to recognize the risk mitigating benefits of using centrally cleared or exchange-traded products. It is certainly not our intent to discourage the use of lower risk profile products, and we are carefully reviewing comments regarding this issue.

Q2: With the proposed use of Loan-to-Value (LTV) ratios on home mortgages in Basel III, community banks would be required to recordkeep (or keep records of) the LTVs of future and existing mortgage. Some have argued that going back through their existing portfolios and determining each individual loan's LTV at origination would be burdensome and costly. Have you considered applying this standard prospectively for smaller banks and what thoughts have gone into that?

A2: You are correct that the Standardized Approach NPR would require banks to review LTVs of each mortgage loan to determine the appropriate capital charge. Generally, we believe the LTV ratio of a residential mortgage is an important indicator of its risk of default. That being said, the compliance costs of the proposal is one issue among many that have been raised regarding the proposed Standardized Approach NPR treatment of residential mortgages. We take the concerns very seriously and are carefully reviewing these comments with our fellow regulatory agencies.

Q3: Elizabeth Duke recently said that in her discussions with community bankers, more of them report that they are reducing or eliminating their mortgage lending due to regulatory burdens than are expanding their mortgage business. In fact, she says that even if the specific issues in capital proposals can be addressed, the lending regulations might still "seriously impair" the ability of community banks to offer traditional mortgages. How or what are you going to do to ensure that the fragile housing market does not take another hit as it relates to capital requirements and Basel implementation?

A3: We have received many comments and concerns about the proposed changes to the regulatory capital rules and their impact on mortgage finance and the housing market. During the financial crisis, the U.S. housing market experienced unprecedented defaults, which negatively affected the banking system. The proposed changes to the regulatory capital rules

seek to increase the risk sensitivity with respect to residential mortgage loans. Furthermore, the proposals aim to increase the resiliency of the banking system so institutions are able to continue lending through periods of financial stress. However, we take very seriously the concerns of commenters about the proposed risk weights for residential mortgages in the Standardized Approach NPR. Concerns raised by commenters include compliance costs, effects of the higher risk weights on their willingness to offer established products in their communities, uncertainties about the interaction of the proposed rules with other mortgage regulations, and concerns about the fragility of the housing market. These concerns are receiving careful attention as we decide how to proceed with this aspect of the rulemakings.

Response to questions from the Honorable Richard Shelby
by George French, Deputy Director of Policy, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1. Is the U.S. banking system currently adequately capitalized? Please list any studies or data you relied upon to make this determination.

A1: FDIC-insured institutions' weighted average tier 1 capital as a percent of assets (the tier 1 leverage ratio) stood at 9.28 percent as of September 30, 2012. This is a high level of average capitalization relative to recent historical experience and reflects the industry's gradual recovery from the effects of the banking crisis. The regulatory capital NPRs are intended to ensure the industry's capital strength is maintained going forward.

From the FDIC's perspective as deposit insurer, it is very important that the regulatory capital rules provide a sufficient check against excessive leverage in the banking system. In this regard, regulatory capital rules that permitted institutions to enter the crisis with inadequate capital remain in effect. Since January 1, 2008, more than 460 banks have failed and hundreds more became problem banks, reflecting supervisory concern about the inadequacy of their capital relative to the risks they face. Although problem bank numbers are trending down, there were still 694 problem banks at September 30, 2012.

We do not believe the existing capital rules are adequate to prevent a recurrence of the excessive leverage in the banking industry that preceded the recent crisis. The NPRs are an attempt to strengthen the existing rules to better provide for an adequately capitalized industry in the future.

Q2. If the proposed Basel III rules were implemented, would your agency consider the U.S. banking system to be adequately capitalized? Please explain how you made that determination and what studies and data you relied upon.

A2: The analysis attached to my November 14 testimony suggests that changing the capital rules as proposed in the NPRs would require a relatively small subset of insured banks, less than ten percent of insured banks, to increase their capital to comply with the proposed requirements. The vast majority of banks hold capital well in excess of the current rules and of the proposed rules.

This analysis suggests the actual capital held by insured banks would be in aggregate slightly more under the proposed rules than under the current rules. However, the key change is that, as compared to the current rules, the proposed rules would set a stronger floor under banks' actual capital levels. Compared to current rules, the proposed rules would serve to better maintain the capital strength of the industry going forward.

If the NPRs were implemented, many specific aspects of our current capital rules would be strengthened to reduce the likelihood of future capital inadequacy, and increase the likelihood that the industry's current broad position of capital strength would be maintained. In particular,

the NPRs would strengthen the definition of regulatory capital to increase its ability to absorb losses in a number of specific respects; increase the level of minimum and well-capitalized tier 1 risk-based capital requirements by two percentage points; establish a graduated series of capital-distribution restrictions that become progressively more stringent as an institution approaches its minimum capital ratio; and, for the largest banks, establish a supplementary leverage requirement that addresses off-balance sheet activities and significant new capital requirements for derivatives.

Q3. At an FDIC meeting in July, FDIC Director Thomas Hoenig stated that "as proposed, the minimum capital ratios will not significantly enhance financial stability." Bank of England Governor Mervyn King and several prominent economists have said that Basel III capital standards are insufficient to prevent another crisis. Do you disagree with these assertions? If so, why?

A3: The proposed rules strengthen existing capital requirements in a number of specific respects as described in the answer to question 2. By definition, a stronger capital position means less reliance on debt and, correspondingly, a financing structure that is more flexible in times of adversity. Compliance with the new rules, coupled with strong supervision, should reduce the extent of excessive financial leverage at banking organizations and thereby mitigate the severity of future banking crises.

Q4. Given the cost and complexity of Basel III, do you have any concerns that Basel III will further tilt the competitive landscape in favor of big banks to the detriment of small banks? Have you studied the impact of Basel III on small institutions as compared to their larger counterparts?

A4: We do not believe that Basel III, or the three separate NPRs, collectively favor large banks. There are substantial additional capital requirements for large banks contained in these NPRs. These include a supplementary leverage ratio for advanced approach banks that incorporates off-balance sheet items, capital requirements for credit valuation adjustments associated with derivatives, a countercyclical buffer, and substantial new disclosures. The changes to the agencies' market risk capital requirements finalized in June 2012 further increase capital requirements for the largest organizations. Moreover, it is anticipated that so-called G-SIB capital buffers will be proposed and implemented in a future rulemaking ("G-SIB" refers to "global systemically important bank").

Each agency conducted a statutorily required Initial Regulatory Flexibility Act Analysis of the effect on each NPR on banks with assets less than $175 million. The FDIC concluded that while the Basel III NPR would not have a substantial cost impact on a large number of small institutions, the Standardized Approach NPR would have a substantial cost impact on a large number of small institutions. For purposes of this analysis, a substantial cost impact was considered to be an initial year's expense of at least 2.5 percent of a bank's total non-interest expense or at least five percent of its annual salary and employee benefits expense. Our framework for this analysis was similar to that conducted by the OCC and Federal Reserve. Comments are shedding additional light on these costs, and the FDIC is carefully considering

with our fellow regulators how to address the concerns about implementation costs. As indicated in my testimony, these are proposed rules, not final rules, and we anticipate making changes in response to comments.

Q5. Recently, the agencies announced that they are pushing back the effective date of the proposed Basel III rules beyond January 1, 2013. This affords the agencies more time to carefully review comment letters, engage in additional outreach and collect additional data. Will the agencies use this extra time to conduct an analysis about the impact of the proposed rules on the U.S. economy and a quantitative impact study that covers all banks, regardless of size, before implementing the final rules?

A5: The agencies have conducted a great deal of analysis of the proposals and their potential effects. This includes, as an important part of our process, the review of over 2400 comment letters that have raised a number of substantive issues with specific parts of the proposals. The agencies have not reached decisions about how best to address the comments or whether additional analysis is needed.

Q6. What is the estimated impact of the Basel III rules, if finalized as proposed, on:

a: The U.S. GDP growth?

A6a: A better capitalized banking system should be less susceptible to severe crises. Experience with banking crises is that they have a severely negative effect on economic growth. A study that the agencies participated in developing with the Basel Committee concluded that the beneficial effects on GDP growth over time from reducing the severity of banking crises would be expected to outweigh any economic costs resulting from a modest increase in the cost of credit. In the U.S., where our analysis suggests that most banks' capital already well exceeds the proposed standards, capital-raising costs would not be expected to be substantial.

b. The probability of bank failure?

A6b: There is extensive literature that deals with how banks' financial ratios affect their probability of failure. In all such studies of which we are aware, the level of a bank's capital as a percentage of some measure of its assets is an important indicator of the probability of failure. This is to be expected, as capital is the shock absorber that allows a bank to absorb unexpected losses while continuing to operate.

In our view, the crisis demonstrated that the current capital rules allowed many institutions to operate with capital levels that were too low. Put another way, the rules allowed these institutions to operate at capital levels such that their probability of failure was inappropriately elevated. The proposed rules are intended to give comfort that banks could absorb a high level of losses relative to historical experience, and thereby reduce their probability of failure.

We have not performed numerical estimates of the probability of bank failure under the proposed rules. Such estimates would be bank specific and would depend on a number of factors, including whether a bank needed to raise capital under the proposed rules and the likelihood and severity of future economic shocks.

c. Availability and cost of mortgages, auto loans, student loans and small business credit?

A6c: In general terms, banks should be better able to provide these types of credit going forward, especially during times of economic stress, if they have a strong capital base.

We have received many comments regarding the potential effects of the proposed Standardized Approach rule on the availability and cost of mortgage credit. We are concerned with this potential impact and are carefully studying the comments.

The risk weight on consumer loans held directly by banks is unchanged in the Standardized Approach NPR. Thus, to the extent auto loans and student loans are directly held by banks, their risk weight would be unchanged. In regard to securitized loans, the Standardized Approach NPR proposes to remove references to credit ratings consistent with the Dodd-Frank Act, and the resulting changes may affect the risk weights for securitized auto loans. However, we believe that the senior positions of most securitized auto and student loans held by banks would continue to receive the same 20 percent risk weight they receive today. We continue to study the comments we received on this issue.

With regard to small business credit, the risk weight on commercial loans to small business would remain unchanged under the Standardized Approach NPR. We have heard concerns from commenters that small business loans are often structured as home equity loans. The proposed residential mortgage risk weights could increase the capital requirements for many small business loans structured as home equity loans. As noted above, we are concerned about the comments we received regarding the mortgage risk-weight framework in general and are carefully considering how to proceed. Another aspect of the Standardized Approach NPR that could affect the capital requirements for small business loans is the proposed risk weight for high-volatility commercial real estate (CRE). These are certain loans with CRE collateral that do not comply with the agencies' existing real estate lending standards or where the borrower does not have meaningful equity at risk. The agencies proposed the higher risk weight because imprudent concentrations in CRE lending have been associated with elevated risk of bank failure or problem-bank status.

d. The compliance costs for small, medium and large banks?

A6d: As noted in the answer to question 4, our analysis suggests that the Standardized Approach NPR would have an initial year's implementation cost that exceeds 2.5 percent of total non-interest expense or five percent of annual salary and employee benefits expense for a substantial number of small institutions (those with assets less than $175 million). We have not conducted a similar analysis for larger institutions, but we are reviewing the comments in this respect.

We will carefully consider how to weigh the compliance costs and potential unintended consequences identified by commenters against the goal of a banking system that is more likely to maintain its capital strength going forward so that it can continue to serve as an engine for economic growth. We do expect to make changes to the proposed rules.

e. The cost of insurance for consumers?

A6e: The proposed rules for institutions supervised by the FDIC are not relevant for insurance activities. It is important to note, however, that the July 2011 final rule implementing the risk-based capital floors under the Collins Amendment (Section 171 of the Dodd-Frank Act) amended the FDIC's (and the other banking agencies') general risk-based capital rules to provide that for certain low risk exposures not typically held by banks, the agencies' general risk-based capital requirement would be the requirement established by the Federal Reserve for bank holding companies. This provision was intended to allow the Federal Reserve to appropriately tailor the risk-based capital requirement for certain insurance activities while remaining consistent with the requirements of Section 171.

Q7: Mr. French, in your prepared remarks you stated that the proposed rules "are intended to address identified deficiencies in the existing capital regime" and that "for most insured banks, the proposals would not result in a need to raise new capital." How would the proposed capital standards remedy existing deficiencies if most banks would not need to raise new capital? How do you reconcile your statement that most banks already meet the Basel III standards with your assertion that the proposed rules will improve the quality of capital?

A7: The current rules allowed some banks to enter the crisis with insufficient capital. Since the onset of the crisis, the industry in aggregate has rebuilt its capital strength, but the rules remain in place that would allow banks with a higher risk appetite to unduly increase their leverage, as some did pre-crisis. Strengthening the rules will help ensure the industry maintains its aggregate capital strength going forward.

We also would emphasize that according to the analysis attached to my testimony, roughly five percent to ten percent of insured institutions would need to raise capital to comply with the proposed rules. Although most banks are comfortably above the current and proposed regulatory capital requirements, those proposed requirements are highly relevant for the segment of the industry that drives the costs to the FDIC's Deposit Insurance Fund.

Response to questions from the Honorable Roger Wicker
by George French, Deputy Director of Policy, Division of Risk Management Supervision, Federal Deposit Insurance Corporation

Q1. In comment letters to federal regulators, the Conference of State Banking Supervisors raised concerns regarding the complexity of the approach proposed by federal banking agencies for implementing the Basel III capital accords. How has this input influenced your approach to the rulemaking process?

A1: Many industry participants, including the Conference of State Banking Supervisors, have raised concerns regarding the complexity of the proposed changes to the regulatory capital framework. These concerns, as well as many others expressed through the comment process, are extremely important to the rulemaking process. The FDIC takes these concerns seriously, and we will strive to reduce complexity where feasible.

Q2. In applying Basel III to community banks, did the regulators consider that most privately-held community banks have fewer options for sources of capital than large banks, making it especially challenging for them to raise additional capital in the current economic climate, and that the Basel III proposal could disproportionately impact such community banks?

A2: The FDIC understands that privately held community banks generally have access to fewer sources of equity capital than do larger publicly traded banks. Small banks often raise capital from directors, large shareholders, or other members of their local communities. In part because of their more limited options for raising capital, smaller banking organizations typically hold higher levels of capital relative to their asset size than larger banks. The analysis attached to my testimony suggests that most small banking organizations already hold capital sufficient to meet the higher capital requirements under the proposed Basel III NPR. Further, the prolonged transition period contemplated in the proposal is intended to provide additional time for banks to comply with the changes to the regulatory capital requirements.

These observations are not intended to minimize or diminish the real concerns that many community bank commenters have with some aspects of the Basel III NPR or other NPRs. As I indicated in my testimony, we take these concerns seriously and will work to address concerns about unintended consequences as we consider how to finalize the NPRs.

Q3. Will the implementation of the proposed Standardized Approach and the mandate that mortgage loan-to-values (LTVs) be tracked require many of the nation's smaller banks to make costly software upgrades? If so, have you considered the cost impact of such a requirement on community banks?

A3: Generally, we believe that the loan-to-value ratio of a residential mortgage is a key risk driver that may enhance the risk sensitivity of the capital framework. Nonetheless, we understand the implementation of the proposed Standardized Approach may require many

institutions to make changes to their systems or software. We take very seriously the potential compliance burden of the proposed rules, along with many other concerns that have been raised about the residential mortgage proposals in the Standardized Approach NPR. These concerns are receiving careful attention as we decide how to proceed with this aspect of the NPRs.

Q4. Did the regulators consider the effect on the economy and consumers if community banks reduce mortgage lending significantly due to Basel III?

A4: We have received many comments indicating that the proposed risk weights in the Standardized Approach NPR would reduce mortgage lending significantly. This is not an outcome we desire, and we are giving a great deal of attention to this issue as we decide how to proceed with this aspect of the NPRs.

Q5. Please explain whether or not the proposed higher capital requirements for past due loans are a form of "double accounting," given that banks already are supposed to reserve for these losses.

A5: The proposed Standardized Approach NPR does include a higher risk weight for past-due loans in recognition that these loans are at a higher risk of loss to the banking institutions. Although banks do reserve against expected loan losses, past-due loans may still represent a heightened risk of loss. To the extent a past-due loan has been written down, only the remaining balance on a bank's balance sheet would be assigned the higher risk weight. That said, we understand the concern that commenters have raised about this issue and are carefully considering how to proceed.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

May 1, 2013

Honorable Steven Pearce
House of Representatives
Washington, D.C. 20515

Dear Congressman Pearce:

This letter is in response to a question you asked the FDIC witnesses at the hearing before the Subcommittee on Financial Institutions and Consumer Credit entitled "State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions?"

You asked for a comparison of the FDIC's spending for its risk management (safety and soundness) and compliance supervision programs, and the number of staff-hours spent yearly on compliance versus safety and soundness. In 2012, the FDIC dedicated approximately 4.03 million staff hours and spent $419.8 million on risk management supervision and 1.12 million staff hours and $105.6 million on compliance supervision.

As you know, the FDIC is statutorily responsible for overseeing banks both for sound financial condition and for compliance with consumer protection and fair lending statutes and regulations. The FDIC has found that the stability of our financial system depends on a regulatory environment that fosters both safe and sound banking and fair treatment for consumers. It is our experience that strong risk management and compliance supervision programs are mutually supportive.

Your interest in this matter is appreciated. If you or your staff have further questions or comments, please contact the Office of Legislative Affairs at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

May 13, 2013

Honorable Shelley Moore Capito
Chairman
Subcommittee on Financial Institutions and Consumer Credit
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Madam Chairman:

Thank you for the opportunity to respond to questions submitted subsequent to testimony by Federal Deposit Insurance Corporation employees Doreen Eberley, Director of Risk Management Supervision, Brett Edwards, Director of Resolutions and Receiverships, and Richard Brown, Chief Economist, at the hearing on "The State of Community Banking: Is the Current Regulatory Environment Adversely Affecting Community Financial Institutions" before the House Subcommittee on Financial Institutions and Consumer Credit on March 20, 2013.

Enclosed are our responses. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to Questions from
the Honorable Shelley Moore Capito
by the Federal Deposit Insurance Corporation

Q1: The Dodd-Frank Act calls for coordination between the CFPB and prudential regulators during the rulewriting process. Please provide the subcommittee with an account of the advice the FDIC provided to the CFPB of how the recent CFPB mortgage rules will affect community banks. Please include a list of recommendations the CFPB accepted and a list of recommendations the CFPB ignored.

A1: As you know, the Dodd-Frank Act established the Consumer Financial Protection Bureau (CFPB) and included a series of changes to the laws governing mortgage lending. These statutory changes have been the subject of rulemaking by the CFPB in consultation with the FDIC and the other prudential regulators.

In our experience, the CFPB's consultation process regarding the mortgage rules has been robust and useful. The CFPB shares information, convenes meetings regularly, and engages in substantive discussions with the FDIC and the other prudential regulators, along with HUD, FHFA, and Treasury.

In requiring these rulemakings, Congress directed the CFPB, the FDIC, and the other prudential regulators to be cognizant of the differences that exist among banks, specifically citing rural and community banks for somewhat differential treatment. As the primary regulator of the nation's community banks, the FDIC has been mindful of these distinctions and of congressional intent in this regard. The FDIC engages in frequent communication with community banks, trade associations, and other industry stakeholders and with our Community Bank Advisory Committee. These interactions provide invaluable and current insight to the FDIC about how community banks undertake their mortgage business, and the opportunity to hear directly from community bankers about their concerns. We have brought our knowledge and understanding of community banks, gained through both these conversations and our examination program, as well as our commitment to consumer protection, to the various consultations and meetings with the CFPB on all the mortgage regulations. This includes conveying our understanding of the role community banks play in providing mortgage lending services in rural and underserved areas, and the challenges and opportunities these institutions face on an ongoing basis.

In 2011, the FDIC also launched a Community Bank Initiative that on an ongoing basis updates the FDIC's understanding of the role of community banks in the financial marketplace and further assists the FDIC in identifying the challenges and opportunities these institutions face going forward. Consistent with the results of the knowledge gained through the FDIC's Community Bank Initiative, FDIC staff put particular emphasis on the unique business model of these community banks in its consultations with the CFPB.

Community banks have a business model that is based on an overall banking relationship with their customers. As a general rule, community banks use a "high touch" model, rather than a "high volume, low margin" model. This allows community banks to compete in the mortgage marketplace based on customer service and underwriting that is successful because of strong relationships with customers. We also have highlighted that, in general, smaller institutions with

a relationship-based model did not face the considerable challenges that affected large financial organizations during the mortgage crisis. The majority of community banks used sensible mortgage underwriting practices during the pre-crisis years, even as overall market discipline declined.

Specific concerns about the proposed rules that we heard from community bankers and trade associations and shared with the CFPB are as follows:

- Restrictions on the origination of balloon loans would have a significant adverse effect on community banks, particularly those located in rural areas given that balloon loans may comprise a significant portion of available and customary mortgage credit in the communities they serve.
- The Qualified Mortgage definitions of "rural" and "underserved" were complicated and, in addition, would not cover enough community banks.
- Mortgage servicing requirements would have a disproportionate impact on small mortgage servicers, who have not demonstrated the problems associated with the large mortgage servicers.
- Requiring escrow would drive community banks, particularly rural community banks, out of the mortgage business because of the associated costs.
- Mortgage loan originator rules were making it difficult for community banks to maintain their level of personal service.

In addition to hearing these concerns conveyed through the FDIC, we are aware that the CFPB also met with community banks and trade associations, and received thousands of comment letters from community banking organizations, consumer advocacy groups, and others. The final rules promulgated by the CFPB suggest greater sensitivity to the needs and interests of community banks, particularly rural community banks, as those needs and interests were expressed to the FDIC and subsequently transmitted to the CFPB, than did the proposed rules. In addition, several of the final rules reduce requirements for community banks compared to current law.

Q2: Appendix B of the study provides information from interviews with community bankers on the growing cost of compliance. While I understand it is difficult to quantify this costs as it is a time burden on the institutions; policy makers, regulators, and financial institutions have to work together to reduce this burden. Is there anyone within the FDIC that is designated as quantifying the overall regulatory burden facing community banks?

A2: The FDIC takes seriously its commitment to better understand the costs of regulation and we have several of our divisions working on initiatives to monitor and find ways to keep those costs to a minimum consistent with the imperatives of safe and sound banking and consumer protection.

As described in Appendix B of the *FDIC Community Banking Study*, community banks often do not specifically track and do not specifically report compliance costs. In fact, bankers that participated in the interviews indicated that they do not track compliance costs because it is too time consuming, costly, and difficult to break out specific costs. Nevertheless, the Study was able to make extensive use of the available regulatory data to better understand the factors that

determine community bank earnings, including changes in noninterest expenses (which include compliance costs). We continue to monitor these trends, and have immediate plans to update several elements of our analysis of bank earnings. The FDIC actively seeks, receives, and acts upon feedback from community bankers about the supervisory process in general and regulatory burden in particular. For example, the FDIC has established the FDIC Advisory Committee on Community Banking, held FDIC regional roundtable discussions of the community banking operating environment, conducted a 2012 review of examination and supervisory guidance, and conducted post examination surveys, as well as undertaking other initiatives.

We have found the interviews and roundtable discussions conducted with community bankers as part of the *Community Banking Study* to be useful in understanding regulatory cost issues.

Q3: Appendix B identified specific regulations that required significant time and resources for compliance, including HMDA, BSA, UDAP, Fair Lending, USA PATRIOT Act, and EFTA. Is the FDIC working with other prudential regulators and the CFPB to review these regulations to identify ones that are duplicative, unnecessary, or outdated? If not, please identify ways the FDIC is working to review these laws to reduce regulatory burden.

A3: The FDIC does not have rulemaking authority for the laws listed in this question. However, the FDIC undertakes a comprehensive review of its regulations every ten years, has taken steps to refine examination and enforcement procedures related to the Home Mortgage Disclosure Act, and is taking other steps to identify and eliminate unnecessary regulatory burden generally.

- The FDIC, jointly with the other federal banking agencies, every ten years undertakes a comprehensive review of each of its regulations as required by the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). The focus of the EGRPRA review is to identify any outdated, unnecessary, or unduly burdensome regulatory requirements imposed on insured depository institutions. The FDIC completed its last review under EGRPRA in 2006 and must complete the next comprehensive review by 2016. To prepare for the upcoming EGRPRA review process, the FDIC published on its website and sought public comment in early 2012 on a plan outlining the process for this review. To the extent the FDIC receives comments on regulations for which it does not have rulemaking authority, the FDIC will forward these comments to the relevant agencies.

- Examination and enforcement procedures related to the Home Mortgage Disclosure Act (HMDA) have been the subject of significant attention by the FDIC during the past several years. We have sought to refine our processes to best achieve our supervisory objective of the accurate reporting of loan-level mortgage data by the 60 percent of FDIC-supervised institutions subject to HMDA reporting thresholds. The majority of HMDA reporters have less than 100 reportable transactions per year. In 2011, the FDIC implemented changes related to its examination procedures associated with HMDA data validation and submission to improve the efficiency of examinations of large HMDA reporters (over 500 reportable transactions in a year). The changes include reviewing these data before the start of an examination, segmenting sampling techniques by the size of the institution's mortgage activity, and refining statistical methods to increase confidence in sampling results.

- Based on the experience implementing the 2011 changes and a review of our supervisory strategy, the FDIC implemented further refinements in October 2012 to our HMDA examination and enforcement procedures. Key changes include: 1) revising sampling techniques for small reporters (less than 100 reportable transactions) to avoid triggering additional file review for minor errors; and 2) limiting imposition of civil money penalties to situations where an institution's level of errors is significantly above the threshold for resubmission and the violations are deemed egregious. We are monitoring the results of these changes to ensure we achieve our supervisory objectives of accurate data reporting in an efficient and reasonable manner.

- As part of the FDIC's Community Banking Initiative, the FDIC undertook comprehensive reviews of examination and rulemaking processes and has taken several actions to address findings from those reviews. For example, we have developed a tool that generates pre-examination request documents tailored to the bank's specific operations and business lines. In addition, we revised the classification system for citing violations in Compliance Reports of Examination to better communicate to institutions the severity of violations and provide more consistency in the classification of violations. We also have modified our Financial Institution Letters (FIL), the vehicle we use to alert banks to any regulatory changes or guidance, to include a section making clear the applicability to smaller institutions (under $1 billion).

Q4: Representatives from the FDIC often mention the FDIC ombudsman as a way for FDIC supervised institutions to appeal the decision of an examiner. Please describe the different avenues FDIC supervised institution can appeal a decision by an examiner.

A4: The FDIC provides the insured financial institutions it supervises a variety of formal and informal processes for appealing examination results. These processes include: an informal resolution of issues through the field and regional supervision staffs; an informal resolution of issues through the FDIC's Ombudsman; formal and informal reviews by the appropriate Division Director; and ultimately a formal appeal to a FDIC Board-level committee, the Supervisory Appeals Review Committee (SARC), in appropriate circumstances. The FDIC outlined these formal and informal appeals processes to financial institutions in the FIL *Reminder on FDIC Examination Findings*, dated March 1, 2011, and in an article published in the Summer 2012 issue of *Supervisory Insights* entitled "The Risk Management Examination and Your Community Bank."

Both the FIL and the *Supervisory Insights* article encourage institutions to discuss concerns about examination findings, assigned ratings, or other supervisory determinations with the examiner-in-charge or the appropriate field or regional office. They also remind financial institutions of the option to contact the FDIC's Office of the Ombudsman, which serves as an independent, confidential, and neutral liaison. When contacted, the Ombudsman's office explains and, as appropriate, assists institutions with questions or concerns related to appeals of material supervisory determinations; answers questions about FDIC policies and procedures and concerns regarding open or closed bank matters; and assists with complaints regarding FDIC operations, employees, and contractors. The Ombudsman also can help resolve complaints against the FDIC by listening, clarifying the issues, and working with both parties to reach an

acceptable solution. The FDIC Ombudsman does not take sides and seeks to ensure a fair process.

The FIL also communicates the formal appeals process outlined in the Amendments to the *Guidelines for Appeals of Material Supervisory Determinations* (adopted April 13, 2010). Under these guidelines, a financial institution may file a request for review of a material supervisory determination with the Division Director. The Director issues a written determination, including the grounds for that determination, within 45 days of receipt of request. If the institution is not satisfied with the results of this review, it can appeal the Director's decision to the SARC. The SARC will review the appeal for consistency with the policies, practices, and mission of the FDIC and the overall reasonableness of, and the support offered for, the positions advanced. The SARC will notify the institution, in writing, of its decision concerning the disputed material supervisory determination(s) within 45 days from the date the SARC meets to consider the appeal.

Q4(a): Please provide the subcommittee with a statistical breakdown of how many financial institutions pursued either an informal or formal appeal with the FDIC in 2012.

A4(a): In 2012, approximately 347 industry representatives contacted the FDIC Ombudsman to request assistance. Of this number, 20 lodged complaints about the FDIC. Other informal channels encourage financial institutions to resolve disputes during the examination at the field office level and review process at the regional office level; however, these discussions are not tracked. With respect to formal appeals in 2012, nine institutions filed a Request for Review with the Director of the Division of Risk Management Supervision, and one institution filed an Appeal with the SARC. During 2012, no institutions filed a Request for Review with the Director of Depositor and Consumer Protection or filed an Appeal with the SARC.

Q4(b): Please include a statistical analysis of the ombudsman decision including the number of appeals that were ruled in favor of the institution, the number ruled in favor of the agency, and split decisions.

A4(b): The Ombudsman resolved or mitigated the 20 complaints (referenced in our response above) or referred them to another party for resolution when appropriate. In the majority of these cases, the Ombudsman was able to provide assistance by explaining FDIC policy and procedures and identifying appropriate FDIC contacts. With respect to the nine Requests for Review filed with the Director of the Division of Risk Management Supervision, three were denied; one was returned because the bank self-liquidated; one was a split decision, with the RMS Director finding in favor of the bank on some issues and in favor of the region in others; and four were withdrawn, after the material supervisory determinations in dispute were satisfactorily resolved in favor of the banks by the applicable regional office. The SARC appeal was denied. The FDIC Office of Inspector General's August 2012 Report entitled *The FDIC's Examination Process for Small Community Banks* reviewed the appeals process and stated that "determinations provide evidence that the SARC is considering the underlying merits of both the institution and the examiners' positions and, as such, is considering the substance of the disagreement and not simply whether or not the examiners followed established policy."

Response to Questions from
the Honorable Spencer Bachus
by the Federal Deposit Insurance Corporation

Q1: The FDIC announced community banks initiatives in 2012 including regional round tables, community bank study and more importantly examination and rule making review. Where are these in the process; what are the findings or results? What has been implemented as a result of these efforts? What have they done to help our community banks?

A1: The FDIC launched the Community Banking Initiative in February 2012 with a national conference on community banking. The FDIC held Roundtable discussions in the FDIC's six regions from March 2012 to October 2012. The FDIC released the *FDIC Community Banking Study* in December 2012. Throughout 2012, the FDIC's Division of Risk Management Supervision and Division of Depositor and Consumer Protection undertook a comprehensive review of the examination and rulemaking processes to identify opportunities to make these processes more efficient and effective, without altering the FDIC's supervisory standards. A full report of the findings from the roundtables and the examination and rulemaking review is available at http://www.fdic.gov/regulations/resources/cbi/rtreport.html#FullReport.

Overall, the findings from these initiatives indicate the community banking model remains viable, and that community banks will be an important part of the financial landscape for years to come. The findings also identified financial and operational challenges facing community banks as well as opportunities for the FDIC to strengthen the efficiency and effectiveness of its examination and rulemaking processes.

The FDIC has undertaken the following actions to address the examination and rulemaking review findings:

- Developed a tool that generates pre-examination request documents tailored to a bank's specific operations and business lines;
- Improved how information is shared electronically between bankers and examiners through its secure Internet channel, FDIC*connect*, which will ensure better access for bankers and examiners;
- Revised the classification system for citing violations in Compliance Reports of Examination to better communicate to institutions the severity of violations and provide more consistency in the classification of violations;
- Developed and posted a Regulatory Calendar on www.fdic.gov to keep bankers current on the issuance of rules, regulations, and guidance;
- Released the first in a series of technical assistance videos to provide useful information to bank directors, officers, and employees on areas of supervisory focus and proposed regulatory changes; and
- Created the Director's Resource Center web page to enhance technical assistance provided to bankers on a range of bank regulatory issues.

Response to Questions from
the Honorable Steve Pearce
by the Federal Deposit Insurance Corporation

Q1: Over the past two years the FDIC has taken a position that there is a misconception that regulators require the write downs of loans to creditworthy buyers. In recent testimony, FDIC directors reasserted that they "are not aware of, and the OIG did not identify, any instances where a bank failed due to supervisor required write-downs of current loans – so-called "paper losses." I would like the FDIC to provide proof of this misconception.

A1: Public Law 112-88, signed into law on January 3, 2012, required the FDIC Office of Inspector General to conduct a study that included a review of the impacts of significant losses arising from current loans. In its January 2013 Report to Congress titled *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions* (OIG Report), the Office of Inspector General did not note improper classification of performing loans. The OIG Report states, "We did not identify any instance of an institution failure caused by significant losses arising from loans for which all payments of principal, interest, and fees were current." They also found that "...examiners usually did not classify as loss loans that the institution claimed were paying as agreed without justification..." Additionally, the OIG Report indicated that, "Examiners most frequently supported loan charge-offs on current loans for conditions such as lack of performance and lack of guarantor support (35 percent of the classification reasons), repayment capacity such as inadequate cash flow or unknown ability to service debt (32 percent of the classification reasons), or weak or inadequate collateral or collateral-dependent loans (25 percent of the classification reasons)." The OIG Report states that "[aggressive growth, asset concentrations, poor underwriting, and deficient credit administration coupled with declining real estate values] led to write-downs and charge-offs on delinquent and non-performing real estate loans as opposed to examiner-required write-downs or fair value accounting losses."

It is important to recognize that some loans may be reflected as "current" on a bank's books due to the inappropriate use of extensions, renewals, interest reserves, capitalization of accrued interest, below market terms, or failure to consider the borrower's ability to repay for the foreseeable future on a global cash flow basis. Examiners are instructed in the *Risk Management Manual of Examination Policies* to assess each loan on the basis of its own characteristics and consider multiple factors that go beyond payment status, such as: the risk of the project being financed; the nature and degree of collateral security; the character, capacity, financial responsibility, and record of the borrower; and the feasibility and probability of the loan's orderly liquidation in accordance with specified terms.

Q2: Please provide information as to how the FDIC evaluates the ability of the borrower to repay.

A2: As stated in the FDIC *Risk Management Manual of Examination Policies*, ability of the borrower to repay generally means the borrower must have the earnings or liquid assets sufficient to meet interest payments and provide for reduction or liquidation of principal as agreed at a reasonable and foreseeable date.

Q3: Please provide information on loans that have been or are being written down across the United States from 2011- to present date. Please provide this information nationally, and specifically for the state of New Mexico.

A3: The following table provides charge-off data for the nation and for the state of New Mexico. The charge-off data are provided as a dollar amount and as a percentage of loans.

	National	New Mexico
2011 Net Charge-Offs ($)	$113.2 billion	$99.5 million
2011 Net Charge-Off Rate	1.55%	1.17%
2012 Net Charge-Offs ($)	$82.8 billion	$51.9 million
2012 Net Charge-Off Rate	1.10%	0.61%

Response to Questions from
the Honorable Lynn Westmoreland
by the Federal Deposit Insurance Corporation

Q1: Please provide the percentage of payouts to date for each SLA (shared loss agreement)

A1: A chart of Shared Loss Agreements and the percentage of claims paid from the initially covered assets for each agreement is attached.

Q2: How many banks with pre-2007 UFIRs rating of 1 and 2 have failed from 2008-2013? Please provide a list of these failed banks.

A2: Of the 470 banks and thrifts that were closed by their chartering authorities from January 1, 2008 through April 12, 2013, where the FDIC was appointed receiver, 401, or 85 percent, were 1- or 2-rated on December 31, 2006. The sudden declines in real estate values during the crisis caused rapid deterioration in the financial condition of many depository institutions. In its *Comprehensive Study on the Impact of the Failure of Insured Depository Institutions*, the FDIC Office of Inspector General found that many banks that failed expanded lending and relaxed underwriting standards "to keep pace with rapid growth in construction and real estate development, rising mortgage demands, and increased competition." When the financial crisis hit and real estate values declined precipitously (according to the Inspector General's report, commercial real estate values declined by more than 42 percent), many institutions with rapid growth in construction and real estate development lending faced significant losses that resulted in rapid deterioration in financial condition, and ultimately, in failure.

A list of the failed banks that were 1- or 2- rated as of year-end 2006 is attached.

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
IndyMac Federal Bank, FSB	3%	N/A
Downey Savings & Loan Assn	1%	N/A
PFF Bank & Trust	5%	18%
Suburban Federal Savings Bank	6%	28%
County Bank	2%	8%
Alliance Bank	11%	14%
Pinnacle Bank of Oregon	0%	12%
Heritage Community Bank	11%	30%
Freedom Bank of Georgia	5%	25%
Colorado National Bank	20%	12%
Teambank, NA	5%	20%
Cape Fear Bank	4%	10%
Great Basin Bank of Nevada	2%	7%
American Sterling Bank	22%	9%
BankUnited, FSB	22%	16%
Strategic Capital Bank	0%	29%
Cooperative Bank	6%	30%
First National Bank of Anthony	15%	13%
Southern Community Bank	10%	41%
Neighborhood Community Bank	19%	38%
Horizon Bank	13%	12%
Mirae Bank	N/A	13%
Elizabeth State Bank	3%	13%
Founders Bank	4%	20%
Rock River Bank	6%	16%
The John Warner Bank	0%	40%
First State Bank of Winchester	1%	23%
First National Bank of Danville	3%	25%
Temecula Valley Bank	0%	0%
Vineyard Bank	7%	12%
First Piedmont Bank	3%	33%
Security Bank of Bibb County	17%	22%
Security Bank of Gwinett County	43%	51%
Security Bank of Houston County	8%	18%
Security Bank of Jones County	9%	29%
Security Bank of North Fulton	32%	29%
Security Bank of North Metro	31%	40%
Waterford Village Bank	1%	3%
Community First Bank	15%	24%
Mutual Bank	4%	31%
Peoples Community Bank	4%	17%
First State Bank	16%	21%
Community National Bank of Sarasota County	10%	16%
Community Bank of Arizona	41%	24%
Colonial Bank	3%	16%
Guaranty Bank	6%	5%
Capital South Bank	9%	14%
Ebank	14%	34%
First Coweta	21%	33%
Bradford Bank	2%	16%
Affinity Bank	4%	14%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Mainstreet Bank	13%	19%
Vantus Bank	1%	13%
Brickwell Community Bank	13%	23%
Venture Bank	10%	18%
Irwin Union Bank and Trust Company	7%	9%
Irwin Union Bank, FSB	5%	11%
Georgian Bank	10%	26%
Southern Colorado National Bank	11%	9%
Jennings State Bank	19%	15%
San Joaquin Bank	7%	11%
American United Bank	N/A	20%
First DuPage Bank	9%	31%
Flagship National Bank	17%	25%
Riverview Community Bank	9%	13%
California National Bank	1%	8%
San Diego National Bank	2%	7%
Bank USA, NA	8%	13%
Community Bank of Lemont	14%	36%
North Houston Bank	14%	10%
Pacific National Bank	2%	7%
Park National Bank	4%	9%
Citizens National Bank	0%	5%
Madisonville State Bank	N/A	3%
Prosperan Bank	12%	23%
United Security Bank	31%	21%
United Commercial Bank	1%	8%
Century Bank, FSB	19%	40%
Orion Bank	7%	31%
Commerce Bank of Southwest Florida	25%	20%
The Buckhead Community Bank	32%	31%
Benchmark Bank	6%	30%
AmTrust Bank	6%	6%
Greater Atlantic Bank	0%	4%
First Security National Bank	19%	30%
Republic Federal Bank, N.A.	3%	10%
Valley Capital Bank, N.A.	32%	38%
SolutionsBank	7%	19%
Imperial Capital Bank	1%	15%
New South Federal Savings Bank	7%	20%
Peoples First Community Bank	8%	34%
First Federal Bank of California	0%	0%
Horizon Bank	3%	16%
St. Stephen State Bank	5%	19%
Town Community Bank and Trust	18%	25%
Evergreen Bank	4%	7%
Premier American Bank	5%	20%
Charter Bank	2%	9%
Columbia River Bank	7%	10%
First Regional Bank	N/A	12%
American Marine Bank	6%	10%
First National Bank of Georgia	16%	23%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Community Bank & Trust	20%	32%
Florida Community Bank	6%	20%
1st American State Bank of Minnesota	N/A	6%
George Washington Savings Bank	12%	34%
La Jolla Bank, FSB	5%	13%
Marco Community Bank	8%	14%
Carson River Community Bank	6%	6%
Rainier Pacific Bank	2%	7%
Bank of Illinois	5%	10%
Sun American Bank	9%	17%
LibertyPointe Bank	0%	7%
The Park Avenue Bank	1%	18%
Statewide Bank	8%	9%
Old Southern Bank	26%	12%
Century Security Bank	0%	27%
Appalachian Community Bank	13%	38%
American National Bank	N/A	5%
Bank of Hiawassee	6%	21%
First Lowndes Bank	8%	5%
Desert Hills Bank	25%	23%
Key West Bank	5%	3%
McIntosh Commercial Bank	20%	42%
Unity National Bank	7%	20%
Beach First National Bank	9%	24%
AmericanFirst Bank	11%	16%
Butler Bank	2%	15%
City Bank	1%	9%
First Federal Bank of North Florida	3%	12%
Innovative Bank	N/A	9%
Riverside National Bank of Florida	3%	5%
Tamalpais Bank	0%	0%
Amcore Bank, National Association	3%	13%
Broadway Bank	14%	28%
Lincoln Park Savings Bank	7%	26%
New Century Bank	10%	30%
Peotone Bank and Trust Company	11%	25%
Wheatland Bank	21%	31%
BC National Banks	2%	8%
CF Bancorp	10%	19%
Champion Banks	8%	20%
Frontier Bank	4%	17%
Eurobank	1%	22%
R-G Premier Banks of Puerto Rico	2%	20%
Westernbank Puerto Rico	1%	14%
1st Pacific Bank of California	8%	4%
Towne Bank of Arizona	40%	22%
Midwest Bank and Trust Company	4%	8%
New Liberty Bank	3%	11%
Satilla Community Bank	11%	19%
Southwest Community Bank	19%	21%
Bank of Florida - Southeast	0%	0%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
Bank of Florida - Southwest	0%	0%
Bank of Florida - Tampa Bay	0%	0%
Granite Community Bank, National Association	5%	12%
Sun West Bank	17%	31%
Tierone Bank	3%	9%
Washington First International Bank	3%	14%
Nevada Security Bank	3%	19%
High Desert State Bank	13%	22%
Peninsula Bank	11%	37%
USA Bank	13%	12%
Home National Bank	10%	19%
Mainstreet Savings Bank, FSB	3%	23%
Metro Bank of Dade County	7%	16%
Olde Cypress Community Bank	5%	17%
Turnberry Bank	4%	13%
Woodlands Bank	8%	18%
First National Bank of the South	7%	12%
Crescent Bank and Trust Company	7%	31%
Home Valley Bank	4%	13%
SouthwestUSA Bank	18%	29%
Sterling Bank	6%	18%
Williamsburg First National Bank	4%	7%
Bayside Savings Bank	13%	20%
Coastal Community Bank	12%	18%
Libertybank	9%	14%
Northwest Bank and Trust	2%	16%
The Cowlitz Bank	10%	2%
Ravenswood Bank	8%	32%
Palos Bank and Trust Company	1%	23%
Butte Community Bank	8%	9%
Community National Bank at Bartow	10%	6%
Independent National Bank	2%	8%
Los Padres Bank	4%	13%
Pacific State Bank	9%	14%
Shorebank	4%	14%
Horizon Bank	13%	16%
The Bank of Ellijay	13%	30%
First Commerce Community Bank	15%	27%
ISN Bank	5%	14%
The Peoples Bank	6%	22%
Haven Trust Bank Florida	5%	18%
North County Bank	8%	10%
Shoreline Bank	13%	4%
Wakulla Bank	3%	4%
Premier Bank	4%	15%
Security Savings Bank, F.S.B.	2%	12%
Westbridge Bank and Trust	10%	18%
First Bank of Jacksonville	4%	6%
First Suburban National Bank	1%	9%
Hillcrest Bank	0%	12%
Progress Bank of Florida	5%	26%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
The First National Bank of Barnesville	12%	24%
K Bank	7%	27%
Western Commercial Bank	N/A	15%
Copper Star Bank	16%	22%
Darby Bank & Trust Company	9%	21%
Tifton Banking Company	6%	14%
Allegiance Bank Of North America	4%	2%
First Banking Center	4%	13%
Gulf State Community Bank	6%	14%
Earthstar Bank	2%	1%
Paramount Bank	10%	17%
Appalachian Community Bank, F.S.B.	8%	15%
Chestatee State Bank	3%	23%
United Americas Bank	10%	28%
The Bank Of Miami	4%	6%
First Commercial Bank Of Florida	11%	17%
Legacy Bank	6%	22%
Oglethorpe Bank	9%	20%
CommunitySouth Bank & Trust	N/A	9%
Bank Of Asheville (The)	5%	12%
United Western Bank	1%	12%
American Trust Bank	0%	3%
Community First Bank-Chicago	9%	16%
North Georgia Bank	6%	22%
Peoples State Bank	2%	21%
Citizens Bank Of Effingham	2%	14%
Habersham Bank	3%	32%
San Luis Trust Bank, Fsb	12%	16%
Legacy Bank	2%	5%
The Bank Of Commerce	5%	18%
Nevada Commerce Bank	1%	25%
Western Springs National Bank & Trust	N/A	15%
Bartow County Bank	2%	17%
Heritage Banking Group	1%	3%
New Horizons Bank	9%	20%
Nexity Bank	4%	17%
Superior Bank	1%	20%
Community Central Bank	6%	13%
Cortez Community Bank	5%	18%
First Choice Community Bank	1%	20%
First National Bank Of Central Florida	1%	17%
Park Avenue Bank (The)	1%	18%
Coastal Bank	3%	17%
Atlantic Southern Bank	5%	22%
First Georgia Banking Company	2%	13%
Summit Bank	11%	14%
First Heritage Bank	10%	16%
Atlantic Bank and Trust	3%	9%
Mcintosh State Bank	2%	20%
Mountain Heritage Bank	7%	24%
Colorado Capital Bank	3%	28%

Shared-Loss Agreements

Includes all claim payments through March 31, 2013

Failed Bank	Claim Payment as a % of initial covered assets under single family SLA	Claim Payment as a % of initial covered assets under non-single family SLA
First Chicago Bank & Trust	9%	19%
High Trust Bank	5%	18%
One Georgia Bank	5%	11%
BankMeridian, N.A.	5%	15%
Integra Bank, National Association	1%	9%
The First National Bank Of Olathe	2%	25%
First Southern National Bank	2%	7%
Lydian Private Bank	3%	8%
Creekside Bank	13%	25%
Patriot Bank Of Georgia	6%	30%
The First National Bank Of Florida	4%	18%
Bank Of The Commonwealth	2%	10%
The Riverbank	1%	12%
Sun Security Bank	10%	16%
Blue Ridge Savings Bank, Inc.	11%	15%
Piedmont Community Bank	0%	32%
Community Banks Of Colorado	N/A	17%
Community Capital Bank	1%	25%
Decatur First Bank	7%	12%
Old Harbor Bank	4%	7%
SunFirst Bank	0%	13%
Premier Community Bank Of The Emerald Coast	6%	18%
Central Florida State Bank	1%	10%
The First State Bank	7%	25%
First Guaranty Bank And Trust Co. Of Jacksonville	0%	14%
Patriot Bank Minnesota	N/A	0%
Charter National Bank And Trust	3%	19%
Central Bank of Georgia	4%	8%
Covenant Bank & Trust	1%	11%
Inter Savings Bank, Fsb	3%	3%
Plantation Federal Bank	N/A	9%
Waccamaw Bank	0%	3%
Putnam State Bank	N/A	10%
Security Exchange Bank	N/A	21%
FIRST CHEROKEE STATE BANK	N/A	11%
GEORGIA TRUST BANK	N/A	6%
HEARTLAND BANK	N/A	2%
Jasper Banking Company	N/A	6%
Truman Bank	N/A	4%
First United Bank	0%	0%
Excel Bank	N/A	0%
Community Bank Of The Ozarks	0%	0%
Aggregate Claim Payments as a percent of initial assets under SLA	6%	15%

Disclaimer:

The information presented in the table above has been compiled from loan data supplied by Assuming Institutions as part of their reporting requirements under their respective Shared Loss Agreements. This information has not been subject to audit and no representation is made as to the completeness or accuracy of the information.

Failed Banks with pre-2007 UFIRs 1 and 2

Name	City	State
CAPITALSOUTH BANK	BIRMINGHAM	AL
NEXITY BANK	BIRMINGHAM	AL
SUPERIOR BANK	BIRMINGHAM	AL
FIRST LOWNDES BANK	FORT DEPOSIT	AL
NEW SOUTH FSB	IRONDALE	AL
COLONIAL BANK NATIONAL ASSN	MONTGOMERY	AL
ALABAMA TRUST BANK NA	SYLACAUGA	AL
FIRST SOUTHERN BANK	BATESVILLE	AR
ANB FINANCIAL NATIONAL ASSN	BENTONVILLE	AR
FIRST STATE BANK	FLAGSTAFF	AZ
UNION BANK NATIONAL ASSN	GILBERT	AZ
CACTUS COMMERCE BANK	GLENDALE	AZ
TOWNE BANK OF ARIZONA	MESA	AZ
BANK USA FSB	PHOENIX	AZ
DESERT HILLS BANK	PHOENIX	AZ
WESTERN NATIONAL BANK	PHOENIX	AZ
SUMMIT BANK	PRESCOTT	AZ
COPPER STAR BANK	SCOTTSDALE	AZ
FIRST ARIZONA SAVINGS A FSB	SCOTTSDALE	AZ
LEGACY BANK	SCOTTSDALE	AZ
SAN JOAQUIN BANK	BAKERSFIELD	CA
FIRST BANK OF BEVERLY HILLS	CALABASAS	CA
BUTTE COMMUNITY BANK	CHICO	CA
ALLIANCE BANK	CULVER CITY	CA
GRANITE COMMUNITY BANK N A	GRANITE BAY	CA
IMPERIAL CAPITAL BANK	LA JOLLA	CA
LA JOLLA BANK FSB	LA JOLLA	CA
CALIFORNIA NATIONAL BANK	LOS ANGELES	CA
SECURITY PACIFIC BANK	LOS ANGELES	CA
COUNTY BANK	MERCED	CA
CHARTER OAK BANK	NAPA	CA
CITIZENS BANK OF NORTHERN CA	NEVADA CITY	CA
FIRST HERITAGE BANK N A	NEWPORT BEACH	CA
PALM DESERT NATIONAL BANK	PALM DESERT	CA
CANYON NATIONAL BANK	PALM SPRINGS	CA
INDYMAC BANK FSB	PASADENA	CA
PFF BANK&TRUST	POMONA	CA
VINEYARD BANK NATIONAL ASSN	RANCHO CUCAMONGA	CA
1ST CENTENNIAL BANK	REDLANDS	CA
PACIFIC COAST NATIONAL BANK	SAN CLEMENTE	CA
1ST PACIFIC BANK OF CA	SAN DIEGO	CA
SAN DIEGO NATIONAL BANK	SAN DIEGO	CA
CALIFORNIA SAVINGS BANK	SAN FRANCISCO	CA
UNITED COMMERCIAL BANK	SAN FRANCISCO	CA

TAMALPAIS BANK	SAN RAFAEL	CA
LOS PADRES BANK	SOLVANG	CA
SONOMA VALLEY BANK	SONOMA	CA
PACIFIC STATE BANK	STOCKTON	CA
TEMECULA VALLEY BANK	TEMECULA	CA
AFFINITY BANK	VENTURA	CA
BANK OF CHOICE COLORADO	ARVADA	CO
COLORADO CAPITAL BANK	CASTLE ROCK	CO
COLORADO NATIONAL BANK	COLORADO SPRINGS	CO
UNITED WESTERN BANK	DENVER	CO
NEW FRONTIER BANK	GREELEY	CO
COMMUNITY BANKS OF COLORADO	GREENWOOD VILLAG	CO
FIRSTIER BANK	LOUISVILLE	CO
SOUTHERN COLORADO NB	PUEBLO	CO
SIGNATURE BANK	WINDSOR	CO
SOUTHSHORE COMMUNITY BANK	APOLLO BEACH	FL
TURNBERRY BANK	AVENTURA	FL
COMMUNITY NB OF BARTOW	BARTOW	FL
CENTRAL FLORIDA STATE BANK	BELLEVIEW	FL
SUN AMERICAN BANK	BOCA RATON	FL
BANK OF BONIFAY	BONIFAY	FL
FIRST PRIORITY BANK	BRADENTON	FL
FLAGSHIP NATIONAL BANK	BRADENTON	FL
FREEDOM BANK	BRADENTON	FL
HORIZON BANK	BRADENTON	FL
CORTEZ COMMUNITY BANK	BROOKSVILLE	FL
RIVERSIDE BK GULF COAST	CAPE CORAL	FL
GULF STATE COMMUNITY BANK	CARRABELLE	FL
OLD HARBOR BANK	CLEARWATER	FL
AMERICANFIRST BANK	CLERMONT	FL
OLDE CYPRESS COMMUNITY BANK	CLEWISTON	FL
BANKUNITED FSB	CORAL GABLES	FL
WAKULLA BANK	CRAWFORDVILLE	FL
GULFSOUTH PRIVATE BANK	DESTIN	FL
PENINSULA BANK	ENGLEWOOD	FL
BANK OF FLORIDA SOUTHEAST	FORT LAUDERDALE	FL
COMMERCE BANK OF SW FL	FORT MYERS	FL
RIVERSIDE NB OF FLORIDA	FORT PIERCE	FL
FIRST BANK OF JACKSONVILLE	JACKSONVILLE	FL
FIRST GUARANTY B&T JACKSONVI	JACKSONVILLE	FL
INTEGRITY BANK	JUPITER	FL
KEY WEST BANK	KEY WEST	FL
STERLING BANK	LANTANA	FL
HERITAGE BANK OF FLORIDA	LUTZ	FL
MARCO COMMUNITY BANK	MARCO ISLAND	FL

Failed Banks with pre-2007 UFIRs 1 and 2

COASTAL BANK	MERRITT ISLAND	FL
METRO BANK OF DADE COUNTY	MIAMI	FL
PREMIER AMERICAN BANK	MIAMI	FL
FIRST NB OF FLORIDA	MILTON	FL
BANK OF FLORIDA SOUTHWEST	NAPLES	FL
ORION BANK	NAPLES	FL
PARTNERS BANK	NAPLES	FL
SECURITY BANK NATIONAL ASSN	NORTH LAUDERDALE	FL
INDEPENDENT NATIONAL BANK	OCALA	FL
OCALA NATIONAL BANK	OCALA	FL
FIRST COMMERCIAL BANK OF FL	ORLANDO	FL
OLD SOUTHERN BANK	ORLANDO	FL
FIRST FEDERAL BANK OF N FL	PALATKA	FL
PUTNAM STATE BANK	PALATKA	FL
LYDIAN PRIVATE BANK	PALM BEACH	FL
PEOPLES FIRST COMMUNITY BANK	PANAMA CITY	FL
COASTAL COMMUNITY BANK	PANAMA CITY BEAC	FL
SUNSHINE STATE CMTY BANK	PORT ORANGE	FL
BAYSIDE SAVINGS BANK	PORT SAINT JOE	FL
FIRST PEOPLES BANK	PORT SAINT LUCIE	FL
CENTURY BANK A FSB	SARASOTA	FL
FIRST STATE BANK	SARASOTA	FL
LANDMARK BANK OF FLORIDA	SARASOTA	FL
BANK OF FLORIDA TAMPA BAY	TAMPA	FL
FIRST COML BK OF TAMPA BAY	TAMPA	FL
COMMUNITY NB SARASOTA CNTY	VENICE	FL
FIRST NB OF CENTRAL FLORIDA	WINTER PARK	FL
ENTERPRISE BANKING CO	ABBEVILLE	GA
NORTHWEST BANK&TRUST	ACWORTH	GA
MONTGOMERY BANK&TRUST	AILEY	GA
ALPHA BANK&TRUST	ALPHARETTA	GA
INTEGRITY BANK	ALPHARETTA	GA
SECURITY BANK OF N FULTON	ALPHARETTA	GA
BANKERS BANK	ATLANTA	GA
BUCKHEAD COMMUNITY BANK	ATLANTA	GA
GEORGIAN BANK	ATLANTA	GA
OMNI NATIONAL BANK	ATLANTA	GA
ONE GEORGIA BANK	ATLANTA	GA
UNITED AMERICAS BANK NA	ATLANTA	GA
FIRST NB OF BARNESVILLE	BARNESVILLE	GA
HOMETOWN COMMUNITY BANK	BRASELTON	GA
OGLETHORPE BANK	BRUNSWICK	GA
GEORGIA TRUST BANK	BUFORD	GA
MCINTOSH COMMERCIAL BANK	CARROLLTON	GA
WEST GEORGIA NATIONAL BANK	CARROLLTON	GA

Failed Banks with pre-2007 UFIRs 1 and 2

BARTOW COUNTY BANK	CARTERSVILLE	GA
UNITY NATIONAL BANK	CARTERSVILLE	GA
HABERSHAM BANK	CLARKESVILLE	GA
MOUNTAIN HERITAGE BANK	CLAYTON	GA
FREEDOM BANK OF GEORGIA	COMMERCE	GA
COMMUNITY BANK&TRUST	CORNELIA	GA
CHESTATEE STATE BANK	DAWSONVILLE	GA
DECATUR FIRST BANK	DECATUR	GA
GLOBAL COMMERCE BANK	DORAVILLE	GA
FIRST COMMERCE CMTY BANK	DOUGLASVILLE	GA
CENTURY SECURITY BANK	DULUTH	GA
HAVEN TRUST BANK	DULUTH	GA
NEW HORIZONS BANK	EAST ELLIJAY	GA
APPALACHIAN COMMUNITY BANK	ELLIJAY	GA
BANK OF ELLIJAY	ELLIJAY	GA
FIRST GEORGIA BANKING CO	FRANKLIN	GA
GORDON BANK	GORDON	GA
PIEDMONT COMMUNITY BANK	GRAY	GA
SECURITY BANK OF JONES CNTY	GRAY	GA
BANK OF HIAWASSEE	HIAWASSEE	GA
MCINTOSH STATE BANK	JACKSON	GA
CRESCENT BANK&TRUST CO	JASPER	GA
JASPER BANKING CO	JASPER	GA
COMMUNITY CAPITAL BANK	JONESBORO	GA
FRONTIER BANK	LAGRANGE	GA
AMERICAN UNITED BANK	LAWRENCEVILLE	GA
COMMUNITY BANK	LOGANVILLE	GA
ATLANTIC SOUTHERN BANK	MACON	GA
SECURITY BANK OF BIBB COUNTY	MACON	GA
SECURITY EXCHANGE BANK	MARIETTA	GA
FIRST BANK OF HENRY COUNTY	MCDONOUGH	GA
FIRST COWETA BANK	NEWNAN	GA
NEIGHBORHOOD COMMUNITY BANK	NEWNAN	GA
FIRST SECURITY NATIONAL BANK	NORCROSS	GA
SECURITY BK OF HOUSTON CNTY	PERRY	GA
TATTNALL BANK	REIDSVILLE	GA
COVENANT BANK&TRUST	ROCK SPRING	GA
COMMUNITY BANK OF ROCKMART	ROCKMART	GA
AMERICAN SOUTHERN BANK	ROSWELL	GA
AMERICAN TRUST BANK	ROSWELL	GA
SATILLA COMMUNITY BANK	SAINT MARYS	GA
FIRST NATIONAL BANK	SAVANNAH	GA
UNITED SECURITY BANK	SPARTA	GA
CITIZENS BANK OF EFFINGHAM	SPRINGFIELD	GA
FIRST SOUTHERN NATIONAL BANK	STATESBORO	GA

Failed Banks with pre-2007 UFIRs 1 and 2

FIRST STATE BANK	STOCKBRIDGE	GA
FIRSTCITY BANK	STOCKBRIDGE	GA
SOUTHERN HORIZON BANK	STOCKBRIDGE	GA
PATRIOT BANK OF GEORGIA	SUWANEE	GA
SECURITY BK OF GWINNETT CNTY	SUWANEE	GA
TIFTON BANKING CO	TIFTON	GA
PARK AVENUE BANK	VALDOSTA	GA
DARBY BANK &TRUST CO	VIDALIA	GA
COMMUNITY BANK OF WEST GA	VILLA RICA	GA
NORTH GEORGIA BANK	WATKINSVILLE	GA
FIRST PIEDMONT BANK	WINDER	GA
PEOPLES BANK	WINDER	GA
CREEKSIDE BANK	WOODSTOCK	GA
FIRST CHEROKEE STATE BANK	WOODSTOCK	GA
SECURITY BANK OF NORTH METRO	WOODSTOCK	GA
POLK COUNTY BANK	JOHNSTON	IA
FIRST FEDERAL BANK	SIOUX CITY	IA
FIRST BANK OF IDAHO FSB	KETCHUM	ID
COUNTRY BANK	ALEDO	IL
BENCHMARK BANK	AURORA	IL
NATIONAL BANK OF COMMERCE	BERKELEY	IL
STRATEGIC CAPITAL BANK	CHAMPAIGN	IL
BROADWAY BANK	CHICAGO	IL
COMMUNITY FIRST BANK CHICAGO	CHICAGO	IL
CORUS BANK NATIONAL ASSN	CHICAGO	IL
FIRST EAST SIDE SAVINGS BANK	CHICAGO	IL
LINCOLN PARK SAVINGS BANK	CHICAGO	IL
NEW CENTURY BANK	CHICAGO	IL
NEW CITY BANK	CHICAGO	IL
PARK NATIONAL BANK	CHICAGO	IL
RAVENSWOOD BANK	CHICAGO	IL
SHOREBANK	CHICAGO	IL
JOHN WARNER BANK	CLINTON	IL
FIRST UNITED BANK	CRETE	IL
FIRST NB OF DANVILLE	DANVILLE	IL
MERIDIAN BANK	ELDRED	IL
ELIZABETH STATE BANK	ELIZABETH	IL
MIDWEST BANK&TRUST CO	ELMWOOD PARK	IL
FIRST CHOICE BANK	GENEVA	IL
HERITAGE COMMUNITY BANK	GLENWOOD	IL
MUTUAL BANK	HARVEY	IL
CHARTER NATIONAL BANK&TRUST	HOFFMAN ESTATES	IL
FIRST CHICAGO BANK&TRUST	ITASCA	IL
COMMUNITY BANK OF LEMONT	LEMONT	IL
BANK OF LINCOLNWOOD	LINCOLNWOOD	IL

Failed Banks with pre-2007 UFIRs 1 and 2

CITIZENS NATIONAL BANK	MACOMB	IL
FIRST SUBURBAN NATIONAL BANK	MAYWOOD	IL
BANK OF ILLINOIS	NORMAL	IL
INTERSTATE BANK	OAK FOREST	IL
ROCK RIVER BANK	OREGON	IL
GEORGE WASHINGTON SB	ORLAND PARK	IL
PALOS BANK&TRUST CO	PALOS HEIGHTS	IL
PEOTONE BANK&TRUST CO	PEOTONE	IL
CITIZENS FIRST NATIONAL BANK	PRINCETON	IL
AMCORE BANK NATIONAL ASSN	ROCKFORD	IL
FARMERS &TRADERS STATE BANK	SHABBONA	IL
BANK OF SHOREWOOD	SHOREWOOD	IL
INDEPENDENT BANKERS BANK	SPRINGFIELD	IL
VALLEY COMMUNITY BANK	ST. CHARLES	IL
WESTERN SPRINGS NB&T	WESTERN SPRINGS	IL
FIRST DUPAGE BANK	WESTMONT	IL
PREMIER BANK	WILMETTE	IL
FIRST STB OF WINCHESTER IL	WINCHESTER	IL
BANK OF COMMERCE	WOOD DALE	IL
FOUNDERS BANK	WORTH	IL
IRWIN UNION BANK FSB	COLUMBUS	IN
IRWIN UNION BANK&TRUST CO	COLUMBUS	IN
INTEGRA BANK NATIONAL ASSN	EVANSVILLE	IN
SHELBY COUNTY BANK	SHELBYVILLE	IN
FIRST NB OF ANTHONY	ANTHONY	KS
HEARTLAND BANK	LEAWOOD	KS
FIRST NATIONAL BANK OF OLA	OLATHE	KS
SECURITY SAVINGS BANK FSB	OLATHE	KS
HILLCREST BANK	OVERLAND PARK	KS
SOLUTIONSBANK	OVERLAND PARK	KS
TEAMBANK NATIONAL ASSN	PAOLA	KS
THUNDER BANK	SYLVAN GROVE	KS
COLUMBIAN BANK&TRUST CO	TOPEKA	KS
STATEWIDE BANK	TERRYTOWN	LA
BUTLER BANK	LOWELL	MA
BAY NATIONAL BANK	BALTIMORE	MD
BRADFORD BANK	BALTIMORE	MD
IDEAL FEDERAL SAVINGS BANK	BALTIMORE	MD
AMERICAN PARTNERS BANK	BETHESDA	MD
BANK OF THE EASTERN SHORE	CAMBRIDGE	MD
SUBURBAN FSB	CROFTON	MD
K BANK	RANDALLSTOWN	MD
HARVEST BANK OF MARYLAND	ROCKVILLE	MD
COMMUNITY BANK OF DEARBORN	DEARBORN	MI
MICHIGAN HERITAGE BANK	FARMINGTON HILLS	MI

Failed Banks with pre-2007 UFIRs 1 and 2

PARAMOUNT BANK	FARMINGTON HILLS	MI
PEOPLES STATE BANK	HAMTRAMCK	MI
COMMUNITY CENTRAL BANK	MOUNT CLEMENS	MI
CITIZENS STATE BANK	NEW BALTIMORE	MI
MAIN STREET BANK	NORTHVILLE	MI
NEW LIBERTY BANK	PLYMOUTH	MI
CITIZENS FIRST SAVINGS BANK	PORT HURON	MI
WARREN BANK	WARREN	MI
1ST REGENTS BANK	ANDOVER	MN
STATE BANK OF AURORA	AURORA	MN
FIRST COMMERCIAL BANK	BLOOMINGTON	MN
NORTHWEST COMMUNITY BANK	CHAMPLIN	MN
MAINSTREET BANK	FOREST LAKE	MN
MARSHALL BANK NATIONAL ASSN	HALLOCK	MN
1ST AMERICAN STB OF MN	HANCOCK	MN
HOME SAVINGS OF AMERICA	LITTLE FALLS	MN
INTER SB FSB D B INTERBANK F	MAPLE GROVE	MN
COMMUNITY SECURITY BANK	NEW PRAGUE	MN
COMMUNITY NATIONAL BANK	NORTH BRANCH	MN
WASHINGTON COUNTY BANK	OAKDALE	MN
RIVERVIEW COMMUNITY BANK	OTSEGO	MN
HORIZON BANK	PINE CITY	MN
ROSEMOUNT NATIONAL BANK	ROSEMOUNT	MN
PINEHURST BANK	SAINT PAUL	MN
JENNINGS STATE BANK	SPRING GROVE	MN
PATRIOT BANK MINNESOTA	WYOMING	MN
RIVERBANK	WYOMING	MN
BC NATIONAL BANKS	BUTLER	MO
SUN SECURITY BANK	ELLINGTON	MO
GLASGOW SAVINGS BANK	GLASGOW	MO
HUME BANK	HUME	MO
PREMIER BANK	JEFFERSON CITY	MO
BANK OF LEETON	LEETON	MO
SOUTHWEST COMMUNITY BANK	OZARK	MO
EXCEL BANK	SEDALIA	MO
TRUMAN BANK	ST. LOUIS	MO
AMERICAN STERLING BANK	SUGAR CREEK	MO
COMMUNITY BANK OF THE OZARKS	SUNRISE BEACH	MO
HERITAGE BANKING GROUP	CARTHAGE	MS
FIRST NATIONAL BANK	ROSEDALE	MS
BANK OF ASHEVILLE	ASHEVILLE	NC
BLUE RIDGE SAVINGS BANK INC	ASHEVILLE	NC
WACCAMAW BANK	WHITEVILLE	NC
CAPE FEAR BANK	WILMINGTON	NC
COOP BANK	WILMINGTON	NC

Failed Banks with pre-2007 UFIRs 1 and 2

TIERONE BANK	LINCOLN	NE
SHERMAN COUNTY BANK	LOUP CITY	NE
MID CITY BANK INC	OMAHA	NE
HIGH DESERT STATE BANK	ALBUQUERQUE	NM
CHARTER BANK	SANTA FE	NM
FIRST COMMUNITY BANK	TAOS	NM
GREAT BASIN BANK OF NEVADA	ELKO	NV
SILVER STATE BANK	HENDERSON	NV
WASHINGTON MUTUAL BANK	HENDERSON	NV
COMMUNITY BANK OF NEVADA	LAS VEGAS	NV
NEVADA COMMERCE BANK	LAS VEGAS	NV
SECURITY SAVINGS BANK	LAS VEGAS	NV
SUN WEST BANK	LAS VEGAS	NV
FIRST NB OF NEVADA	RENO	NV
NEVADA SECURITY BANK	RENO	NV
LIBERTYPOINTE BANK	NEW YORK	NY
OHIO SAVINGS BANK FSB	CLEVELAND	OH
BRAMBLE SAVINGS BANK	MILFORD	OH
AMERICAN NATIONAL BANK	PARMA	OH
FIRST STATE BANK OF ALTUS	ALTUS	OK
HOME NATIONAL BANK	BLACKWELL	OK
FIRST STATE BANK	CAMARGO	OK
FIRST NATIONAL BANK OF DAVIS	DAVIS	OK
FIRST CAPITAL BANK	GUTHRIE	OK
HOME VALLEY BANK	CAVE JUNCTION	OR
LIBERTYBANK	EUGENE	OR
COMMUNITY FIRST BANK	PRINEVILLE	OR
SILVER FALLS BANK	SILVERTON	OR
COLUMBIA RIVER BANK	THE DALLES	OR
ALLEGIANCE BANK OF N AMERICA	BALA CYNWYD	PA
AMERICAN EAGLE SAVINGS BANK	BOOTHWYN	PA
NOVA SAVINGS BANK	PHILADELPHIA	PA
PUBLIC SAVINGS BANK	SOUTHAMPTON	PA
EUROBANK	HATO REY	PR
R-G PREMIER BANK OF RQ	HATO REY	PR
WESTERNBANK PUERTO RICO	MAYAGUEZ	PR
BANKMERIDIAN N A	COLUMBIA	SC
COMMUNITYSOUTH BANK&TRUST	EASLEY	SC
WILLIAMSBURG FIRST NB	KINGSTREE	SC
BEACH FIRST NATIONAL BANK	MYRTLE BEACH	SC
PLANTATION FEDERAL BANK	PAWLEYS ISLAND	SC
FIRST NB OF THE SOUTH	SPARTANBURG	SC
TENNESSEE COMMERCE BANK	FRANKLIN	TN
BANKEAST	KNOXVILLE	TN
FARMERS BANK OF LYNCHBURG	LYNCHBURG	TN

Failed Banks with pre2007 UFIRs 1 and 2

GUARANTY BANK	AUSTIN	TX
MILLENNIUM STB OF TEXAS	DALLAS	TX
FRANKLIN BANK SSB	HOUSTON	TX
NORTH HOUSTON BANK	HOUSTON	TX
LA COSTE NATIONAL BANK	LA COSTE	TX
MADISONVILLE STATE BANK	MADISONVILLE	TX
FIRST INTERNATIONAL BANK	PLANO	TX
SANDERSON STATE BANK	SANDERSON	TX
CITIZENS NATIONAL BANK	TEAGUE	TX
ADVANTA BANK CORP	DRAPER	UT
BARNES BANKING CO	KAYSVILLE	UT
AMERICA WEST BANK	LAYTON	UT
CENTENNIAL BANK	OGDEN	UT
SUNFIRST BANK	SAINT GEORGE	UT
MAGNETBANK	SALT LAKE CITY	UT
BANK OF THE COMMONWEALTH	NORFOLK	VA
VIRGINIA BUSINESS BANK	RICHMOND	VA
NORTH COUNTY BANK	ARLINGTON	WA
AMERICAN MARINE BANK	BAINBRIDGE ISLAN	WA
HORIZON BANK	BELLINGHAM	WA
WESTSOUND BANK	BREMERTON	WA
BANK OF WHITMAN	COLFAX	WA
FRONTIER BANK	EVERETT	WA
VENTURE BANK	LACEY	WA
COWLITZ BANK	LONGVIEW	WA
CITY BANK	LYNNWOOD	WA
EVERGREEN BANK	SEATTLE	WA
WASHINGTON FIRST INTL BANK	SEATTLE	WA
SHORELINE BANK	SHORELINE	WA
FIRST HERITAGE BANK	SNOHOMISH	WA
PIERCE COMMERCIAL BANK	TACOMA	WA
RAINIER PACIFIC BANK	TACOMA	WA
WESTSIDE COMMUNITY BANK	UNIVERSITY PLACE	WA
BANK OF CLARK COUNTY	VANCOUVER	WA
FIRST BANKING CENTER	BURLINGTON	WI
BADGER STATE BANK	CASSVILLE	WI
LEGACY BANK	MILWAUKEE	WI
BANK OF ELMWOOD	RACINE	WI
EVERGREEN STATE BANK	STOUGHTON	WI
MARITIME SAVINGS BANK	WEST ALLIS	WI
AMERIBANK INC	WELCH	WV
BANK OF WYOMING	THERMOPOLIS	WY

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

May 29, 2013

Honorable Mike Crapo
Ranking Minority Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Crapo:

I am writing to follow up on the discussion during the February 14 Senate Banking Committee hearing on "Wall Street Reform: Oversight of Financial Stability and Consumer and Investor Protections" regarding analyses and efforts by the financial regulators to understand and quantify the anticipated cumulative effects of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) rules.

The Federal Deposit Insurance Corporation seeks to avoid imposing any unnecessary costs or burdens on the industry or the public in its rulemaking and other regulatory endeavors generally. As described in the FDIC's recently updated Statement of Policy on the Development and Review of FDIC Regulations and Policies, the FDIC gives careful consideration to the need for issuing a regulation and, once that need is determined, evaluates benefits and costs, based on available information, and considers reasonable and possible alternatives. The Statement of Policy makes clear that the main alternatives, once identified as available, should be described and analyzed for their consistency with statutory or policy objectives, effectiveness in achieving those objectives, and burden on the public or industry. As part of any notice-and-comment process, the FDIC typically seeks comment on the potential for less burdensome or more effective alternatives and carefully considers all comments, including those that focus on costs to the industry, before issuing a final rule.

The FDIC is committed to ensuring that our rulemaking and supervisory activities do not impose unnecessary costs or burdens on the banking industry or the public and that we are mindful of the effectiveness of our regulations as a whole when deliberating on new rules – whether under Dodd-Frank or otherwise.

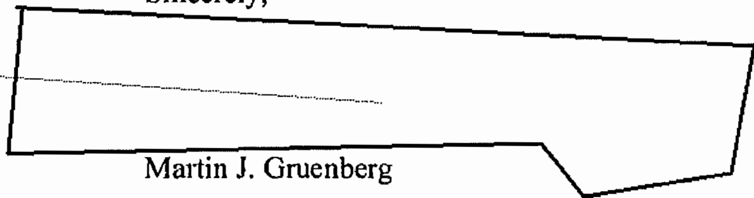
The Government Accountability Office (GAO) has noted the difficulty of determining the comprehensive costs of Dodd-Frank rulemakings and has stated that it is too soon to assess the effects of the Dodd-Frank Act. In its January 2013 report, the GAO stated that "the Dodd-Frank Act's full impact on [financial firms'] businesses, operations, and earnings remains uncertain, in part because of the rulemakings that still need to be completed," and that "even when the reforms have been fully implemented, it may not be possible to determine precisely the extent to which observed costs can be attributed to the act versus other factors, such as changes in the economy."

In evaluating the extent to which the FDIC is considering the cumulative burden of all Dodd-Frank rulemakings on market participants and the economy, the FDIC's independent Office of Inspector General (OIG) has found that the "FDIC is working on a number of efforts to establish clear rules under the Dodd-Frank Act that will ensure financial stability while implementing those rules in a targeted manner to avoid unnecessary regulatory burden."[1] The FDIC will continue to evaluate the benefits and costs of its Dodd-Frank regulations as the entire regulatory structure is completed and its effects become more fully known and understood.

Thank you for your continued interest in this important topic. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Eric Spitler, Director, Office of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)



Martin J. Gruenberg

[1] "Evaluation of the FDIC's Economic Analysis of Three Rulemakings to Implement Provisions of the Dodd-Frank Act," FDIC Office of Inspector General (June 2011): 19.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

May 30, 2013

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for the opportunity to respond to questions submitted by Senator Crapo, Senator Warner, Senator Heitkamp, and Senator Toomey subsequent to my recent testimony at the hearing on "Wall Street Reform: Oversight of Financial Stability and Consumer Investor Protections" before the Senate Banking on February 14, 2013.

Enclosed are my responses for the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Eric Spitler, Director of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg

Enclosure

Response to questions from the Honorable Mike Crapo
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Given how complex it is to determine whether a trade is a hedge or a proprietary trade, it appears the real issue is whether a trade threatens the safety and soundness of the bank. What benchmark does your agency use to determine whether a particular activity is or is not "hedging"? How does your agency determine whether the trade presents risks to the safety and soundness of a financial institution?

A1: The FDIC does not have a single benchmark that it uses to determine whether a particular activity constitutes hedging as distinguished from proprietary trading. We do have certain standards that are used to determine whether activities constitute a hedge for purposes of financial reporting or, in certain instances, as an input into the bank's regulatory capital calculations. However, these standards vary based upon the purpose for which an exposure serves as a hedge. For example, in the context of financial reporting, banks use the strict hedge accounting requirements set forth by the Financial Accounting Standards Board; but, for calculating market risk capital requirements, banks can rely on their own models for determining whether an exposure provides hedging benefits. The hedging requirements in the proposed Volcker Rule are important steps forward in promoting a general standard that can be used by the banking agencies to determine whether any particular activity is legitimate hedging as opposed to proprietary trading, which introduces additional risk. While our examiners routinely review the activities of a financial institution to determine consistency with safety and soundness standards, we view the Volcker Rule as providing the FDIC with important additional tools to help determine whether an activity poses additional risk to a financial institution.

Q2: Federal Reserve, FDIC, and OCC have issued proposed rules to implement Dodd-Frank and Basel III capital requirements for U.S. institutions. Late last year, your agencies pushed back the effective date of the proposed Basel III rules beyond January 1, 2013. Given the concerns that substantially higher capital requirements will have a negative impact on lending, are your agencies using this extra time to conduct a cost-benefit analysis about the impact of the proposed rules on the U.S. economy, availability and cost of credit, cost of insurance, and the regulatory burden on institutions, before implementing the final rules?

A2: In June 2012, the FDIC along with the other banking agencies approved for public comment three notices of proposed rulemaking that collectively would implement the Basel III framework, the Basel II standardized approach, and other recent enhancements to the international capital framework adopted by the Basel Committee, as well as certain provisions of the Dodd-Frank Act (the NPRs).[1] For purposes of the NPRs, the agencies conducted the cost and burden analyses required by the Regulatory Flexibility Act, the Paperwork Reduction Act, and

[1] See 77 Fed. Reg. 52792 (Aug. 30, 2012); 77 Fed. Reg. 52888 (Aug. 30, 2012); and 77 Fed. Reg. 52978 (Aug. 30, 2012).

the Unfunded Mandates Reform Act of 1995, all of which are further detailed in the NPRs.[2] The agencies have invited public comment on these analyses.

The agencies also participated in the development of a number of studies to assess the potential impact of the revised capital requirements, including participating in the Basel Committee's Macroeconomic Assessment Group (MAG) as well as its Quantitative Impact Study, the results of which were made publicly available by the Basel Committee on Banking Supervision upon their completion.[3] Basel Committee analysis has suggested that stronger capital requirements could help reduce the likelihood of banking crises while yielding positive net economic benefits.[4] Specifically, a better capitalized banking system should be less vulnerable to banking crises, which have historically been extremely harmful to economic growth. Moreover, the MAG analysis found that the requirements would only have a modest negative impact on the gross domestic product of member countries, and that any such negative impact could be significantly mitigated by phasing in the proposed requirements over time.[5] Taken together, these studies suggest that a better capitalized banking system will better support economic growth sustainably over time.

The agencies also sought public comment on the proposed requirements in the NPRs to better understand their potential costs and benefits. The agencies asked several specific questions in the NPRs about potential costs related to the proposals and are considering all comments carefully. During the comment period, the agencies also participated in various outreach efforts, such as engaging community banking organizations and trade associations, among others, to better understand industry participants' concerns about the NPRs and to gather information on their potential effects. In addition, to facilitate public comment, the agencies developed and provided to the industry an estimation tool that would allow an institution to estimate the regulatory capital impact of the NPRs. These efforts have provided valuable additional information to assist the agencies as we determine how to proceed with the proposed rulemakings.

Q3: Given the impact that the Qualified Mortgages (QM) rules, the proposed Qualified Residential Mortgages (QRM) rules, the Basel III risk-weights for mortgages, servicing, escrow and appraisal rules will have on the mortgage market and the housing recovery, it is crucial that these rules work in concert. What analysis has your agency conducted to assess how these rules work together? What is the aggregate impact of those three rules, as proposed and finalized, on the overall mortgage market as well as on market participants?

A3: At the time of the release of the regulatory capital NPRs, the QM and QRM rules had not been released in final form. Accordingly, in connection with the proposed treatment for 1-4

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[2] See e.g., the Initial Regulatory Flexibility Analysis for the Basel III NPR, 77 Fed. Reg. 52792, 52833 (Aug. 30, 2012).

[3] See "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements" (MAG Analysis), also available at: http://www.bis.org/publ/othp12.pdf; see also "Results of the comprehensive quantitative impact study," also available at: http://www.bis.org/publ/bcbs186.pdf.

[4] See "An assessment of the long-term economic impact of stronger capital and liquidity requirements," Executive Summary, pg.1.

[5] See MAG Analysis, Conclusions and open issues, pgs.9-10.

family residential mortgage loans, the agencies solicited comment on alternative criteria or approaches for differentiating among the levels of risk inherent in different mortgage exposures. Specifically, the agencies invited comment on whether "all residential mortgage loans that meet the 'qualified mortgage' criteria to be established for purposes of the Truth in Lending Act pursuant to section 1412 of the Dodd-Frank Act [should] be included in category 1."[6] The agencies are considering the comments received in connection with the proposed treatment for 1-4 family residential mortgage exposures, as well as comments received in response to the NPR relating to Credit Risk Retention, which included proposed QRM standards.[7] Now that we have the benefit of the final QM rule, the agencies can consider QRM and Basel III in light of the QM standards. All three rules -- QM, QRM, and Basel III -- could impact the mortgage market. In the FDIC's view, it is important that the agencies endeavor in the final rulemaking on QRM and Basel III to take into consideration the cumulative impact of the rules on the mortgage market, including the availability of credit.

Q4: Under the Basel III proposals mortgages will be assigned to two risk categories and several subcategories, but in their proposals the agencies did not explain how risk weights for those subcategories are determined and why they are appropriate. How did your agency determine the appropriate range for those subcategories?

A4: The agencies currently are reviewing the numerous comment letters from banking organizations on whether the proposed methodology and risk weights for category 1 and 2 residential mortgages are appropriate. As stated in the preamble to the Standardized Approach NPR, the U.S. housing market experienced unprecedented levels of defaults and foreclosures due in part to qualitative factors such as inadequate underwriting standards, high risk mortgage products such as so-called payment-option adjustable rate mortgages, negatively amortizing loans, and the issuance of loans to borrowers with undocumented and unverified income. In addition, the agencies noted that the amount of equity a borrower has in a home is highly correlated with default risk. Therefore, the agencies proposed to assign higher risk weights to loans that have higher credit risk while assigning lower risk weights to loans with lower credit risk.

The agencies also recognize that the use of loan-to-value (LTV) ratios to assign risk weights to residential mortgage exposures is not a substitute for and does not otherwise release a banking organization from its responsibility to have prudent loan underwriting and risk management practices consistent with the size, type, and risk of its mortgage business. In deliberations on the final rule, the agencies also are reviewing the interagency supervisory guidance documents on risk management involving residential mortgages, including the Interagency Guidance on Nontraditional Mortgage Product Risks (October 4, 2006); the interagency Statement on Subprime Mortgage Lending (July 10, 2007), and the Appendix A to Subpart A of Part 365 of the FDIC Rules and Regulations - Interagency Guidelines for Real Estate Lending (December 31, 1992).

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[6] 77 Fed. Reg. 52888, 52899 (Aug. 30, 2012).
[7] 76 Fed. Reg. 24090 (April 29, 2011).

Q5: In a speech last year you stated that the failure of a systemically important financial institution will likely have significant international operations and that this will create a number of challenges. What specific steps have been taken to improve the cross-border resolution of a SIFI? What additional steps must be taken with respect to the cross-border resolution of a SIFI?

A5: As I stated in my testimony, the experience of the financial crisis highlighted the importance of coordinating resolution strategies across national jurisdictions. Section 210 of the Dodd-Frank Act expressly requires the FDIC to "coordinate, to the maximum extent possible" with appropriate foreign regulatory authorities in the event of the resolution of a covered financial company with cross-border operations. As we plan internally for such a resolution, the FDIC has continued to work on both multilateral and bilateral bases with our foreign counterparts in supervision and resolution. The aim is to promote cross-border cooperation and coordination associated with planning for an orderly resolution of a globally active, systemically important financial institution (G-SIFIs).

As part of our bilateral efforts, the FDIC and the Bank of England, in conjunction with the prudential regulators in our jurisdictions, have been working to develop contingency plans for the failure of G-SIFIs that have operations in both the U.S. and the U.K. Of the 28 G-SIFIs designated by the Financial Stability Board of the G-20 countries, four are headquartered in the U.K, and another eight are headquartered in the U.S. Moreover, around two-thirds of the reported foreign activities of the eight U.S. SIFIs emanate from the U.K.[8] The magnitude of these financial relationships makes the U.S. – U.K. bilateral relationship by far the most important with regard to global financial stability. As a result, our two countries have a strong mutual interest in ensuring that, if such an institution should fail, it can be resolved at no cost to taxpayers and without placing the financial system at risk. An indication of the close working relationship between the FDIC and U.K authorities is the joint paper on resolution strategies that we released in December.[9]

In addition to the close working relationship with the U.K., the FDIC and the European Commission (E.C.) have agreed to establish a joint Working Group comprised of senior staff to discuss resolution and deposit guarantee issues common to our respective jurisdictions. The Working Group will convene twice a year, once in Washington, once in Brussels, with less formal communications continuing in between. The first of these meetings will take place later this month. We expect that these meetings will enhance close coordination on resolution related matters between the FDIC and the E.C., as well as European Union Member States.

The FDIC also has engaged with Swiss regulatory authorities on a bilateral and trilateral (including the U.K.) basis. Through these meetings, the FDIC has further developed its understanding of the Swiss resolution regime for G-SIFIs, including an in-depth examination of the two Swiss-based G-SIFIs with significant operations in the U.S. In part based on the work of

[8] Reported foreign activities encompass sum of assets, the notional value of off-balance-sheet derivatives, and other off-balance-sheet items of foreign subsidiaries and branches.
[9] "Resolving Globally Active, Systemically Important, Financial Institutions," http://www.fdic.gov/about/srac/2012/gsifi.pdf.

the FDIC, the Swiss regulatory authorities have embraced a single point of entry approach for the Swiss based G-SIFIs.

The FDIC also has had bilateral meetings with Japanese authorities. FDIC staff attended meetings hosted by the Deposit Insurance Corporation of Japan and the FDIC hosted a meeting with representatives of the Japan Financial Services Agency to discuss our respective resolution regimes. The government of Japan has proposed legislation to expand resolution authorities for the responsible Japanese agencies. These bilateral meetings, including an expected principal level meeting later this year, are part of our continued effort to work with Japanese authorities to develop a solid framework for coordination and information-sharing with respect to resolution, including through the identification of potential impediments to the resolution of G-SIFIs with significant operations in both jurisdictions.

These developments mark significant progress in fulfilling the mandate of section 210 of the Dodd-Frank Act and achieving the type of international coordination that would be needed to effectively resolve a G-SIFI in some future crisis situation. The FDIC is continuing efforts to engage our counterparts in other countries in greater coordination to improve the ability to achieve an orderly liquidation in the event of the failure of a large, internationally active financial institution. We will continue to pursue these efforts through both bilateral and multilateral approaches.

Q6: In June of last year, the FDIC proposed a rule that mirrored the Federal Reserve's proposed definition of "predominantly engaged in financial activity." Since this definition triggers FDIC's ability to exercise its orderly liquidation authority, the proposed rule has generated a considerable amount of concern. Does the FDIC intend to reconsider its proposed definition of "predominately engaged in financial activities" to address concerns raised in public comment letters?

A6: Section 201(b) of the Dodd-Frank Act requires the FDIC in consultation with the Secretary of the Treasury to establish certain definitional criteria for determining if a company is predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purposes of section 4(k) of the Bank Holding Company Act. A company that is predominantly engaged in such activities would be considered a "financial company" for purposes of Title II of the Act.

On March 23, 2011, the FDIC published in the *Federal Register* a notice of proposed rulemaking titled "Orderly Liquidation Authority" (March 2011 NPR) that proposed, among other things, definitional criteria for determining if a company is predominantly engaged in activities that are financial in nature or incidental thereto for purposes of Title II. On June 18, 2012, the FDIC published for comment a supplemental notice of proposed rulemaking, which proposed to clarify the scope of activities that would be considered financial in nature or incidental thereto for purposes of the March 2011 NPR (June 2012 NPR).

The FDIC received eight comments responding to the March 2011 NPR and seven comments responding to the June 2012 NPR. The FDIC is currently in the process of reviewing these comments and will consider them carefully in developing its final rule.

Response to questions from the Honorable Mark Warner
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: As you know, a number of people including Sheila Bair have been advocates of using a simple leverage ratio as the primary measure of banks' capital strength. Would focusing on a simple leverage ratio, using the Basel III definition of leverage which includes key off-balance sheet exposures, help cut through the noise of risk weighting and models and cross border differences, and give us all greater confidence that large banks are holding a good amount of high quality capital?

A1: Maintaining a minimum ratio of capital to assets has been a regulatory requirement for U.S. banking organizations since the early 1980s, and a benchmark for supervisors' evaluation of capital adequacy long before that time. Leverage ratio requirements were part of the statutory framework of the Prompt Corrective Action requirements introduced in the FDIC Improvement Act of 1991.[10] Leverage ratio requirements in the United States exist side-by-side with risk-based capital requirements, and each banking organization must have sufficient capital to satisfy whichever requirement is more stringent.

Over time, as risk-based capital requirements have attempted to provide greater differentiation among types and degrees of risk, they also have become increasingly complex, particularly for advanced approaches banking organizations and those subject to the market risk rule.[11] Risk-based capital requirements for these institutions depend largely on the output of internal risk models and have been criticized for being overly complex, opaque, and difficult to supervise consistently. With only risk-based requirements, a banking organization can increase its permissible use of leverage by concentrating in exposures that receive favorable risk weights. Exposures with favorable risk weights, however, can still experience high losses.

Leverage ratio requirements, in contrast, directly constrain bank leverage and thereby offset potential weaknesses in the risk-based ratios and generate a baseline amount of capital in a way that is readily determinable and enforceable. The introduction of a leverage ratio in the international Basel III capital framework is an important step that we strongly support. It is well established that banks with higher capital as measured by the leverage ratio are less likely to fail or experience financial problems. Avoiding capital shortfalls at large institutions is particularly important in containing risks to the financial system and reducing the likelihood of economic disruption associated with problems at these institutions. It is therefore important and appropriate to have a strong leverage capital framework to complement the risk-based capital regulations. This is needed to ensure an adequate base of capital exists in the event the risk-based ratios either underestimate risk or do not inspire confidence among market participants.

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[10] Pub. L. 102-242, 105 Stat. 2236. The PCA requirements were enacted in section 38 of the Federal Deposit Insurance Act., 12 U.S.C. 1831o.

[11] Currently, the market risk capital rule is codified in 12 CFR part 325, appendix C. As of the effective date of the Basel III consolidated final rule, the citation for the market risk rule will be: 12 CFR part 324, subpart F.

Q2: The FDIC and Fed have joint jurisdiction over the completion of living wills from large firms. Now, I don't think anyone expected the first year of plans to be perfect, but can you remind everyone, for the FDIC and Fed to approve the plans, isn't the standard that they have to show how normal liquidation like bankruptcy or FDIC resolution could work under reasonable circumstances? And what progress have the plans made in getting firms to think through their structure, better inform you as regulators, and lead to simplification and rationalization?

A2: On July 1, 2012, the first group of living wills, generally involving bank holding companies and foreign banking organizations with $250 billion or more in non-bank assets, were received. In 2013, the firms that submitted initial plans in 2012 will be expected to refine and clarify their submissions. The Dodd-Frank Act requires that at the end of this process these plans be credible and facilitate an orderly resolution of these firms under the Bankruptcy Code. Four additional firms are expected to submit plans on July 1, 2013, and approximately 115 firms are expected to file on December 31, 2013.

Last year (2012) was the first time any firms had ever created or submitted resolution plans. There were a number of key objectives of this initial submission including:

- Identify each firm's critical operations and its strategy to maintain them in a crisis situation;
- Map critical operations and core business lines to material legal entities;
- Map cross-guarantees, service level agreements, shared employees, intellectual property, and vendor contracts across material legal entities;
- Identify and improve understanding of the resolution regimes for material legal entities;
- Identify key obstacles to rapid and orderly resolution; and
- Use plan information to aid in Title II resolution planning and to enhance ongoing firm supervision.

Each plan was reviewed for informational completeness to ensure that all regulatory requirements were addressed in the plans, and the Federal Reserve and the FDIC have been evaluating each plan's content and analysis.

Following the review of the initial resolution plans, the agencies developed instructions for the firms to detail what information should be included in their 2013 resolution plan submissions. The agencies identified an initial set of significant obstacles to rapid and orderly resolution that covered companies are expected to address in the plans, including the actions or steps the company has taken or proposes to take to remediate or otherwise mitigate each obstacle and a timeline for any proposed actions. The agencies extended the filing date to October 1, 2013, to give firms additional time to develop resolution plan submissions that address the instructions.

Resolution plans submitted in 2013 will be subject to informational completeness reviews and reviews for resolvability under the Bankruptcy Code. The agencies established a set of benchmarks for assessing a resolution under bankruptcy, including a benchmark for cross-border cooperation to minimize the risk of ring-fencing or other precipitous actions. Firms will need to provide a jurisdiction-by-jurisdiction analysis of the actions each would need to take in a resolution, as well as the actions to be taken by host authorities, including supervisory and

resolution authorities. Other benchmarks expected to be addressed in the plans include: the risk of multiple, competing insolvency proceedings; the continuity of critical operations -- particularly maintaining access to shared services and payment and clearing systems; the potential systemic consequences of counterparty actions; and global liquidity and funding with an emphasis on providing a detailed understanding of the firm's funding operations and cash flows.

Through this process, firms will need to think through and implement structural changes in order to meet the Dodd-Frank Act objectives of resolvability through the Bankruptcy Code.

Q3: Are you confident that Title II can work for even the largest and most complex firms? What are the areas where we can still make improvement, and how are we progressing on improving the cross border issues?

A3: We believe that Title II can work for even the largest and most complex firms.

The FDIC has largely completed the rulemaking necessary to carry out its systemic resolution responsibilities under Title II of the Dodd-Frank Act. In July 2011, the FDIC Board approved a final rule implementing the Title II Orderly Liquidation Authority. This rulemaking addressed, among other things, the priority of claims and the treatment of similarly situated creditors.

The FDIC now has the legal authority, technical expertise, and operational capability to resolve a failing systemic resolution. The FDIC introduced its "single entry" strategy for the resolution of a U.S. G-SIFI using the Order Liquidation Authority under Title II of the Dodd Frank Act. Since then the FDIC has been working to operationalize the strategy and enhance FDIC preparedness.

Key activities to operationalize the strategy include:

- Addressing vital issues, including valuation, recapitalization, payments, accounting, and governance, through ongoing internal FDIC projects.
- Developing and refining Title II resolution strategies that consider the specific characteristics of each of the largest U.S. domiciled SIFIs. Summaries of these plans have been shared with domestic and international regulators.
- Actively communicating this approach with key stakeholders to ensure that the market understands what actions the FDIC may take ahead of the failure to minimize irrational or unnecessarily disruptive behavior. In 2012, the FDIC participated in over 20 outreach events with academics and other thought leaders, industry groups, rating agencies, and financial market utilities in order to expand (domestic) communications/outreach efforts regarding Title II OLA.

The FDIC has made great strides in developing cooperation with host supervisors and resolution authorities in the most significant foreign jurisdictions for U.S. G-SIFIs to allow for a successful implementation of the Orderly Liquidation Authority. These dialogues with host supervisors and resolution authorities occur at both the bilateral and multilateral level.

As part of our bilateral efforts, the FDIC and the Bank of England, in conjunction with the prudential regulators in our respective jurisdictions, have been working to develop contingency plans for the failure of G-SIFIs that have operations in both the U.S. and the U.K. Approximately 70 percent of the reported foreign activities of the eight U.S. G-SIFIs emanates from the U.K. An indication of the close working relationship between the FDIC and U.K. authorities is the joint paper on resolution strategies that the FDIC and the Bank of England released in December 2012. This joint paper focuses on the application of "top-down" resolution strategies for a U.S. or a U.K. financial group in a cross-border context and addressed several common considerations to these resolution strategies.

In addition to the close working relationship with the U.K., the FDIC and the European Commission (E.C.) have agreed to establish a joint Working Group comprised of senior staff to discuss resolution and deposit guarantee issues common to our respective jurisdictions. The Working Group will convene twice a year, once in Washington, once in Brussels, with less formal communications continuing in between. The first of these meetings will take place later this month. We expect that these meetings will enhance close coordination on resolution related matters between the FDIC and the E.C., as well as European Union Member States.

The FDIC also has engaged with Swiss regulatory authorities on a bilateral and trilateral (including the U.K.) basis. Through these meetings, the FDIC has further developed its understanding of the Swiss resolution regime for G-SIFIs, including an in-depth examination of the two Swiss-based G-SIFIs with significant operations in the U.S. In part based on the work of the FDIC, the Swiss regulatory authorities have embraced a single point of entry approach for the Swiss based G-SIFIs.

The FDIC also has had bilateral meetings with Japanese authorities. FDIC staff attended meetings hosted by the Deposit Insurance Corporation of Japan and the FDIC hosted a meeting with representatives of the Japan Financial Services Agency, to discuss our respective resolution regimes. The government of Japan has proposed legislation to expand resolution authorities for the responsible Japanese Agencies. These bilateral meetings, including an expected principal level meeting later this year, are part of our continued effort to work with Japanese authorities to develop a solid framework for coordination and information-sharing with respect to resolution, including through the identification of potential impediments to the resolution of G-SIFIs with significant operations in both jurisdictions.

Q4: The statutory language for funds defined under the Volcker Rule pointedly did not include venture funds, however the definition in the proposed rule seemed to indicate that venture funds would be covered. In addition to exceeding the statutory intent of Congress, this has created uncertainty in the market as firms await a final rule and refrain from making commitments which might be swept up in the final version of the Volcker rule. Can you clarify whether venture funds are covered by the Volcker rule?

A4: Section 619(h)(2) of the Dodd-Frank Act defines the terms "hedge fund" and "private equity fund" as "an issuer that would be an investment company, as defined in the Investment Company Act of 1940 *(15* U.S.C. 80a-1 et seq.), but for section 3(c)(1) or 3(c)(7) of that Act, or such similar funds as the appropriate federal banking agencies, the Securities and Exchange

Commission, and the Commodity Futures Trading Commission may, by rule, as provided in subsection (b)(2), determine." This definition, as written, would cover the majority of venture capital funds.

As part of the NPR, the agencies sought public comment on whether venture capital funds should be excluded from the definition of "hedge fund" and "private equity fund" for purposes of the Volcker Rule. In the NPR, the agencies asked:

> Should venture capital funds be excluded from the definition of "covered fund"? Why or why not? If so, should the definition contained in rule 203 *(l)-(*1) under the [Investment] Advisers Act be used? Should any modifications to that definition of venture capital fund be made? How would permitting a banking entity to invest in such a fund meet the standards contained in section 13(d)(1)(J) of the [Bank Holding Company Act]?

In conjunction with the development of the final rule, the agencies are reviewing public comments responding to the NPR, including comments on this question related to venture capital funds. The agencies will give careful consideration to these comments in the development of the final rule.

Response to questions from the Honorable Heidi Heitkamp
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: Chairman Gruenberg and Comptroller Curry: I thank you for understanding that as relationship lenders in local communities, community banks are able to provide much needed financing to both residential and commercial borrowers in rural and underserved areas where larger banks are unable or unwilling to participate. Have you thoroughly considered the impact of higher risk weights from Basel III on community banks, as well as on the local communities where they serve?

A1: The FDIC recognizes the important role that community banks play in the financial system, which includes providing credit to small businesses and homeowners throughout the country. During the comment period, the agencies participated in various outreach efforts, such as engaging community banking organizations and trade associations, among others, to better understand industry participants' concerns about the proposed revisions to the general risk-based capital rules and to gather information on their potential effects. To facilitate comment on the NPRs, the agencies developed and provided to the industry an estimation tool that would allow an institution to estimate the regulatory capital impact of the proposals. The FDIC conducted roundtables in each of our regional offices and hosted a nationwide webcast to explain the components of the rules and answer banker questions. Lastly we developed instructional videos on the two rulemakings applicable to community banks. These videos received more than 7,000 full views in the first three months of availability. We believe these efforts contributed to the more than 2,500 comments we received, which have provided valuable additional information to assist the agencies as we determine how to proceed with the NPRs. Particular attention is being given to the comments on the impact of the proposed rules on community banks.

Q2: Chairman Gruenberg: First, I'd like to thank you and the FDIC for making the community bank industry a priority for your agency. After conducting your study and hosting regional roundtables, what were the most significant problems you found on the ground? What did your agency do to address them?

A2: Community banks play a critical role in the national and local economies by extending credit to consumers and businesses. As you indicate, the FDIC has launched several initiatives to further the understanding of how community banks have evolved during the past 25 years, current opportunities and challenges facing community bankers, and what lies ahead. The FDIC launched the *Community Banking Initiative* in February 2012 with a national conference on community banking. Roundtable discussions were then held in the FDIC's six regions, and the *FDIC Community Banking Study* was released in December 2012. We also conducted comprehensive reviews of our examination and rulemaking processes. Overall, the findings from these initiatives indicate the community banking model remains viable and that community banks will be an important part of the financial landscape for years to come. The findings also identified financial and operational challenges facing community banks as well as opportunities for the FDIC to strengthen the efficiency and effectiveness of its examination and rulemaking processes.

The *FDIC Community Banking Study* is a data-driven effort to identify and explore community bank issues. The first chapter develops a research definition for the community bank that is used throughout the study. Subsequent chapters address structural change, the geography of community banking, comparative financial performance, community bank balance sheet strategies, and capital formation at community banks. This study is intended to be a platform for future research and analysis by the FDIC and other interested parties.

Community bankers identified a number of financial challenges during the roundtable discussions, especially that there is an insufficient volume of quality loans available in many markets. They also stated that capital raises are increasingly difficult in the current banking environment and the low-rate environment is leading to a build-up of interest rate risk. Community bankers also expressed concern about the ability to retain quality staff and how to satisfy customers' demands for greater availability of mobile banking technologies. Although the vast majority of banker comments regarding their experience with the examination process were favorable, a general perception exists that new regulations and heightened scrutiny of existing regulations are adding to the cost of doing business. Community bankers also note there are opportunities to enhance communication with examination staff and expand and strengthen technical assistance provided by the FDIC.

The FDIC has undertaken initiatives to address comments received from bankers during the roundtable discussions. To enhance our examination processes, the FDIC developed a tool that generates pre-examination request documents tailored to a bank's specific operations and business lines. The FDIC is improving how information is shared electronically between bankers and examiners through its secure Internet channel, FDIC*connect,* which will ensure better access for bankers and examiners. We also revised the classification system for citing violations identified during compliance examinations to better communicate to institutions the severity of violations and to provide more consistency in the classification of violations cited in Reports of Examination.

The FDIC also issued a Financial Institution Letter, entitled *Reminder on FDIC Examination Findings* (FIL-13-2011 dated March 1, 2011), encouraging banks to provide feedback about the supervisory process. Since then, we continue to conduct outreach sessions and hold training workshops and symposiums, and have created the Director's Resource Center webpage to enhance technical assistance provided to bankers on a range of bank regulatory issues. Also, the FDIC has developed and posted a Regulatory Calendar on www.fdic.gov to keep bankers current on the issuance of rules, regulations, and guidance; and we are holding industry calls to communicate critical information to bankers about pending regulatory changes.

Response to questions from the Honorable Pat Toomey
by Martin J. Gruenberg, Chairman
Federal Deposit Insurance Corporation

Q1: In response to concerns that the bank-centric Basel III capital standards are unworkable for insurers, the Fed has indicated that it would perform some tailoring of those standards. However, there is continuing concern among the life insurance industry that the proposed tailoring is inadequate and does not properly acknowledge the wide differences between banking and insurance.

- **What kinds of more substantive changes will the Fed consider to the Basel III rulemaking to prevent negative impacts to insurers and the policyholders, savers, and retirees that are their customers?**

There is also a concern that the bank standards are a dramatic departure from the duration matching framework common to insurance supervision.

- **What is your response to that concern and would the Fed consider doing more than just tailoring bank standards?**
- **Do you believe that, from an insurance perspective, Basel III bank standards are an incremental or dramatic departure from current insurance standards?**

A1: Section 171 of the Dodd-Frank Act requires the establishment of minimum consolidated leverage and risk-based capital requirements for savings and loan holding companies, a number of which have significant insurance activities. The FDIC recognizes the distinctions between banking and insurance and the authorities given to the states. In 2011, we amended our general risk-based capital requirements to provide flexibility in addressing consolidated capital requirements for low-risk nonbank activities, including certain insurance-related activities. We will continue to bear in mind these distinctions as we work with our fellow regulators to ensure that the final rule provides for an adequate transition period that is consistent with Section 171.

Q2: Regarding the Volcker Rule, some have suggested that the banking agencies should just go ahead and issue their final rule without waiting to reach agreement with the Securities and Exchange Commission and Commodities Futures Trading Commission, which have to issue their own rules. This scenario could result in there being more than one Volcker Rule, which would create significant confusion about which agency's rule would apply to which covered activity. Do you agree that there should be only one Volcker Rule?

A2: All entities affected by the Volcker Rule should be operating under similar requirements. Section 619(b)(2) of the Dodd-Frank Act contains specific coordinated rulemaking requirements that serve to help clarify the application of individual agency rules, to ensure that agency regulations are comparable, and to require coordination and consistency in the application of the Volcker Rule. To that end, the federal banking agencies, the SEC, and the CFTC are currently working together in the process of developing a final Volcker Rule.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

THOMAS M. HOENIG
VICE CHAIRMAN

July 1, 2013

Honorable Maxine Waters
Ranking Minority Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Congresswoman Waters:

I regret that I did not directly answer your question at the recent hearing of the House Financial Services Committee on the subject of Too Big to Fail.

You asked me whether I thought that the FDIC and Fed have the authorities we need to limit activities by systemic banks if the resolution plans they submit would not allow the banks to be wound down under bankruptcy. I do believe that Title I of the Dodd-Frank Act provides significant authorities to limit the activities of potentially systemic banks if they cannot effectively be resolved through bankruptcy. However, these authorities are tied to a determination of the feasibility of bankruptcy which is where I am concerned that the process could become extended and break down. What I had hoped to suggest was an alternative that would limit the activities of banks benefitting from the federal safety net to only those tied directly to the core business of banking which would strengthen our ability to use Title I for resolving these financial firms.

As I intended to convey in my written and oral testimony, my only goal is to strengthen or fill gaps in any current bank regulatory policy -- including Dodd Frank. My written proposal details my desire to do so by ensuring that the banks, with their federal support, are limited to the generally safe core activities of the banking industry and that the safety net is not extended to the risky speculative activities many institutions engage in today. .

Again, I regret that my answer to you at the hearing was not more directly responsive and would welcome the opportunity to discuss these issues with you at your convenience. I look forward to future appearances in front of the Committee and the opportunity to work with you in the coming years.

Sincerely,

(b)(6)

Thomas M. Hoeing

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

OFFICE OF THE VICE CHAIRMAN

August 7, 2013

Honorable Spencer Bachus
Chairman Emeritus
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Chairman Bachus:

Thank you for your letter enclosing questions subsequent to my appearance before the Committee on July 26, 2013 at the hearing entitled "Examining How the Dodd-Frank Act Could Result in More Taxpayer-Funded Bailouts." Enclosed are responses to those questions.

If I can provide further information, please let me know. I can be reached at (202) 898-6616.

Sincerely,

(b)(6)

Thomas Hoenig
Vice Chairman

Enclosure

**Response to Questions from
the Honorable Spencer Bachus
by Thomas Hoenig**

Q1: In the name of solving "too big to fail," some, including Federal Reserve Governor Tarullo, have proposed increased capital requirements beyond what Basel III mandates, as well as liquidity controls and restrictions on non-deposit borrowing, greater reliance on equity funding, and a tax on size in the form of a surcharge for the largest and most complex institutions. In your opinion, will the rest of the world's financial services regulators follow if proposals such as those are adopted in this country?

A1: Yes, I would suggest that the United States has the opportunity to lead the rest of the world in strengthening the financial industry. Countries that are most successful have strong economies and strong financial systems. Banks must hold capital levels that the market has historically required when no government safety net protected creditors from loss. Stronger capital levels support risk taking and lending to private firms while allowing for mistakes without weakening the entire financial system. Confidence is a key to the stability of the financial system, and adequate capital and strong liquidity serves to instill confidence among the public in its financial firms. Low capital and inadequate liquidity tends to worsen the effects of a financial upheaval on a nation's economic system, as we only too recently learned. It's time for the United States to compete in the global economy from a position of strength once again, and that includes taking the lead on financial regulatory policy. (See article from August 1 Wall Street Journal, which states the U.S. leads the world in imposing stricter capital rules on the biggest banks.[1])

Q2: How would any resulting disparity between U.S. regulations and the rest of the world affect the ability of the U.S. banks to support economic growth and job creation here?

A2: U.S. regulations requiring more capital, more disclosure, and more separation of speculative trading activities from commercial bank activities will strengthen the U.S. banking system relative to foreign bank operations and make our banks more competitive and successful over time. Capital is a source of strength, not a burden. A potential disparity in terms of U.S. institutions being better capitalized compared with their foreign counterparts puts our financial firms not only in a much stronger competitive position, but also in a position to continue to lend through both good times and bad in support of U.S. economic growth and job creation.

Q3: Have you performed any analysis on the impact of high capital requirements and new regulatory mandates on economic growth?

A3: Analysis that has been done on the impact of capitalization levels on economic growth finds that during economic downturns, banks with stronger capital levels do not reduce their lending activities to the same extent that banks with weak capital do. In reviewing data since 1999

[1] http://online.wsj.com/article/SB10001424127887323997004578640314202979922.html?KEYWORDS=Crittenden

regarding the relationship between equity and loan levels for the eight U.S. globally systemic banks, there is no evidence that higher capital leads to lower loan volumes. Studies of stronger capital requirements have been conducted by research staff within the IMF and BIS, and their findings show that banks with strong tangible common equity levels are better able to maintain lending during a crisis, a key factor influencing the speed of the recovery. (See IMF Working Paper: "Balance Sheet Strength and Bank Lending During the Global Financial Crisis" by Kapan and Minoiu, May 2013, http://www.imf.org/external/pubs/ft/wp/2013/wp13102.pdf.)

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

August 7, 2012

Honorable Randy Neugebauer
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Thank you for the opportunity to respond to the questions submitted by you and Congressman Westmoreland subsequent to testimony by Bret Edwards, the Federal Deposit Insurance Corporation's Director of Resolutions and Receiverships, at the hearing on "Oversight of the FDIC's Structured Transaction Program" before the House Subcommittee on Oversight and Investigations on May 16, 2012.

Enclosed are our responses. A copy was provided to Committee staff for the hearing record. If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to questions from the Honorable Randy Neugebauer by Bret D. Edwards, Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation

Q1: How can the FDIC verify that pursuing structured transaction sales will maximize the return to the Deposit Insurance Fund?

A1: The verification is comprised of several components: analysis of performance, evaluation of structured sale results compared to the estimated cash sale value, and monitoring for compliance.

During the structuring process for each LLC, the FDIC's financial advisor prepares an estimated cash flow projection for the pool of loans being conveyed to the LLC, including how the cash flows will flow through the deal structure for distribution to the equity holders. These projections become the FDIC's baseline for subsequent monitoring of transaction performance. In the aggregate, for the 29 LLC transactions closed through September 2011, total projected equity distributions to the FDIC, as of March 31, 2012, are substantially in line with the FDIC's initial projections, with an approximate 0.1 percent difference.

Another measure is the comparison of selling the loans in a structured sale versus a cash sale. The present value of the cash flows to the FDIC on the LLC transactions as of the respective closing dates is compared to the cash sale value to determine the dollar amount of the benefit to the FDIC from having entered into the LLC transaction. As of December 31, 2011, the aggregate present value of actual and projected LLC cash flows to the FDIC, as of the closing dates for each LLC transaction, was approximately $11.7 billion (or 47.2 percent of the initial unpaid principal balance (UPB)), compared to the cash sale values of approximately $7.4 billion (or 29.8 percent of the initial UPB). By this measure, the benefit to the FDIC of having entered into the LLC transactions instead of selling assets for cash is approximately $4.3 billion (or 17.4 percent of initial UPB).

The managing members are required by the LLC agreements to maximize return to the LLC. The FDIC monitors management of the portfolio and compliance with the agreements by reviewing monthly reports, reviewing actual performance against consolidated business plans, and conducting site visitations on at least an annual basis. In addition, the FDIC utilizes an accounting contractor to perform closing and interim management reports and review and process monthly cash flow and account statements.

Q2: What discounts and financing does the FDIC provide to its private sector partners to facilitate structured transaction sales?

A2: When the FDIC as receiver conveys assets to an LLC it receives as payment all of the equity interest in the LLC, as well as, in some cases, purchase money notes. The FDIC then sells a portion of the equity (typically 40 percent) to private sector partners. The LLC repays the purchase money notes over time from cash flow generated by the LLC, and the repayment of the purchase money notes is made prior to the members of the LLC receiving any equity

distributions. The FDIC does not offer any discounts, but rather conveys the assets to the LLC based on the market value of the assets.

It is important to note that the managing member pays cash to the FDIC for its winning bid amount. The FDIC does not finance the managing member's equity interest.

Q3: Can FDIC managing partners use TARP funds to purchase their equity interest in LLCs?

A3: No buyers to date had received TARP funds.

Q4: How many complaints has the FDIC received from borrowers whose loans have been transferred into structured transaction sales?

A4: Of the more than 42,300 assets that the FDIC transferred into structured transactions, the FDIC has received a total of 181 inquiries from borrowers from June 2010 to the present.

Q5: How does the FDIC manage complaints received from borrowers whose loans have been transferred into structured transaction sales?

A5: When the FDIC receives a borrower's inquiry, the following steps are performed:

- We determine if the inquiry is associated with a structured transaction;
- We contact the borrower, usually via email;
- The inquiry is assigned to an FDIC specialist, who contacts the acquirer of the loan to obtain and review the information that will address the borrower's specific concerns;
- Following review and approval, a response is mailed to the inquiring party.

Q6: How many complaints has the FDIC received from Members of Congress advocating on the borrowers' behalf?

A6: From June 2010 to the present, the FDIC has received 80 inquiries from Members of Congress relating to borrowers whose loans were sold in structured transactions.

Q7: How does the FDIC manage complaints received from Members of Congress advocating on the borrowers' behalf?

A7: A Congressional inquiry is handled similarly to a direct inquiry from a borrower described above. Inquiries are carefully tracked to assure a prompt response. The inquiry is assigned to an FDIC specialist, who contacts the acquirer of the loan to obtain and review the information that will address the borrower's specific concerns. Following confirmation that we have a signed

Privacy Act release from the constituent, a response is then prepared for the Member of Congress so they can provide a response to their constituent.

Q8: How many more structured transaction sales are in the pipeline?

A8: There are currently several structured transaction sales in the pipeline. The first to be offered will be a Small Investor Program (SIP) sale from a single receivership. A multi-receivership offering is in the initial planning and development stages. The portfolio has not been finalized, but the sale is expected to include commercial real estate, acquisition development and construction and single family residential loans from 70 receiverships. It is expected that additional loans will be included from new receiverships. The sales are projected to bid in the fourth quarter and close before year-end.

Q9: Is there an end date for the structured transaction sales program?

A9: No, there is no anticipated end date at this time, but frequency and volume is likely to diminish going forward. Nationally, through August 6, 2012 there have been 454 bank failures since the beginning of 2008. While still high, the current pace of failures is slowing. As of August 6, 2012, there have been 40 financial institution failures in 2012 compared to 63 failures at this same point last year. Additionally, a contributing factor that affects the structured transaction sales program is the type of resolution and the number of loans the FDIC retains.

Q10: On what criteria will the FDIC judge the ultimate success of the structured transaction sales program?

A10: The transaction agreement term is generally seven years for commercial real estate and acquisition, development and construction loan sales, and ten years for single family residential loan sales. As such, the success of the structured transaction sales program cannot be completely measured until termination of the agreements. An analysis of the overall recovery considering the costs of marketing and monitoring as compared to selling the loans in a cash sale will be the most meaningful way to judge the success of the program. The FDIC gathers substantial data throughout the course of these transactions so we will have the ability to evaluate costs, recovery, and many other factors.

Q11: Does the FDIC direct its private sector partners' approach to collecting outstanding debt on loans transferred into structured transactions LLCs?

A11: The transaction documents provide that the managing member service and liquidate the assets in the way in which a prudent servicer would do. While the FDIC does not direct the collection efforts of the managing member, the FDIC has a monitoring process in place to ensure that the managing member and its servicer comply with the terms of the Servicing Agreement and other transaction documents. If a servicer fails to comply with the servicing standard, the

FDIC has the right to put the managing member in default and, among other remedies, remove the servicer.

An example of servicing standards for loans secured by single-family properties is the requirement that the managing member implement a loan modification program consisting of either: (i) HAMP, (ii) the FDIC's mortgage loan modification program, or (iii) a managing member proprietary program that is approved by the FDIC.

Q12: Why does Rialto seem to have a much higher number of Congressional inquiries regarding its practices than other managing members in the structured transaction sales program?

A12: Of all structured transactions sold to date, Rialto is the managing member with the highest number of loans. In addition, at the time of the sale, 89 percent were non-performing acquisition, development, and construction (ADC) loans, with many of the remaining loans expected to default prior to their maturity date due to collateral characteristics and type. Over 80 percent of the loans were more than 150 days delinquent. Many of the ADC loans have undeveloped land or vacant land as collateral, and it is difficult to restructure a loan with collateral that does not have a payment stream. The large number of ADC loans combined with the high percentage of delinquencies is a significant contributor to the number of congressional inquiries received by the FDIC. Since the structured transaction sale, the number of inquiries and the percent of these inquiries to total assets transferred to the LLCs is less than 1 percent.

Response to questions from the Honorable Lynn Westmoreland
by Bret D. Edwards, Director, Division of Resolutions and Receiverships,
Federal Deposit Insurance Corporation

Q1: Has the FDIC established a taskforce of independent experts to evaluate and submit recommendations on the high number of bank failures?

A1: Certain internal and external groups are reviewing aspects of the recent banking crisis and have made or will make recommendations to the FDIC regarding changes to policies, programs, and deposit insurance.

As of the end of June 2012, the FDIC's Office of Inspector General (OIG) had completed 96 Material Loss Reviews (MLR), 11 in-depth reviews, and 141 failed bank reviews as required by statute. In addition to those efforts, in May 2009, the OIG issued an internal memorandum that outlined the major causes, trends, and common characteristics of FDIC-supervised financial institution failures that had resulted in a material loss to the DIF. That memorandum, in part, prompted the FDIC to make a number of process changes to its supervision program in order to more quickly identify potential issues in banks at risk of deterioration. In December 2010, the OIG published the results of an audit that identified (1) the actions that the FDIC had taken to enhance its supervision program since the May 2009 memorandum, and (2) trends and issues that had emerged from subsequent MLRs. The OIG's report stated that the FDIC had either implemented or planned actions that substantially addressed its previously reported MLR-related trends and issues and that would enhance the FDIC's supervision program. The report included additional recommendations, which the FDIC's Division of Risk Management Supervision agreed to implement.

The OIG also has embarked on a comprehensive study of bank failures in accordance with Pub. L. No. 112-88, which requires the study of bank failures and the effects of shared-loss agreements; examination policies associated with troubled loans, appraisals, capital, and enforcement orders; and capital investment policies. The legislation also requires the Government Accountability Office to study the causes of bank failures since 2008, as well as similar topics that the OIG is addressing.

Pursuant to the recommendations of a study of Prompt Corrective Action (PCA) by the banking agencies' Inspectors General, FDIC staff is exploring the feasibility of incorporating non-capital triggers into the PCA framework. We also are studying how various risk factors should affect deposit insurance premiums. The FDIC's large insured depository institution assessment system was revised in April 2011 to better differentiate for risk and to better take into account losses the FDIC may incur should a large institution fail. Similarly, staff is evaluating the small bank deposit insurance assessment system to determine if changes are needed to account for risk taking observed in the majority of smaller institutions that have failed in recent years.

In a related area, the FDIC is conducting a comprehensive study of the future of community banking. The study will review the last 25 years and address a variety of issues related to

community banks, including their evolution, characteristics, performance, challenges, and role in supporting local communities. More information on these studies will be available later this year.

Finally, the FDIC established the Advisory Committee on Community Banking in May 2009 to provide the FDIC with advice and guidance on a broad range of critical policy issues impacting small community banks, as well as the local communities they serve. The Advisory Committee, which is composed of a cross-section of community bankers from across the country, has discussed issues related to the financial crisis, the bank resolution process, and the impact of the Dodd-Frank Act on community banks.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

August 12, 2013

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter enclosing a question from Senator Mark Kirk subsequent to testimony by James R. Wigand, Director, Office of Complex Financial Institutions, at the Subcommittee on National Security and International Trade and Finance hearing entitled "Improving Cross Border Resolution to Better Protect Taxpayers and the Economy" on May 15, 2013.

Enclosed is our response. If we can provide further information, please let us know. The Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to question from the Honorable Mark Kirk by the Federal Deposit Insurance Corporation

Question: Dodd-Frank did not specifically enact any new anti-money laundering laws. However, in what ways has the Act impacted existing federal oversight of AML and BSA-compliance in each of your agencies?

Response: As you note in your question, the Dodd-Frank Act did not enact any new anti-money laundering (AML) laws. For the FDIC, the biggest impact on our oversight of AML and Bank Secrecy Act (BSA) compliance in recent years were the significant changes incorporated into the BSA with the passage of the USA Patriot Act in October 2001. In particular, §327 of the USA Patriot Act addresses the effectiveness of insured depository institutions in combatting money laundering activities specifically when an institution proposes a merger. For practical purposes, the statute requires the agency to consider the existence of any supervisory action that includes BSA/AML provisions when processing a merger application.

Generally, the statute requires that a merger cannot be approved with any of the following outstanding issues:

1. Unresolved BSA/AML program violations or provisions in enforcement actions; such violations would result from failures of any component in the BSA/AML Program requirements, which include:
    a. System of internal controls;
    b. Independent review of the BSA/AML Compliance Program;
    c. BSA Officer responsible for daily BSA/AML activities;
    d. BSA/AML training; and
    e. Customer Identification Program.
2. Pending AML investigations or supervisory actions; or
3. Outstanding AML investigations, actions, or pending matters with other relevant agencies (such as Treasury, FinCEN, or law enforcement).

With respect to large, complex institutions, such as those raising concerns regarding cross-border resolutions, the FDIC's direct supervisory role includes the processing of applications seeking to merge the uninsured entity into an insured institution (for example, merging a mortgage subsidiary into an insured bank). We have noted a nominal increase in the number of such merger proposals, which are governed by Section 18 of the FDI Act and which generally seek to rationalize or consolidate corporate structures. In each case, the FDIC must consider each applicable statutory factor, including the effectiveness of the insured institutions involved in the merger in combatting money laundering activities.

Separately, we note that large, complex insured institutions generally have a full range of cross-border activities and relationships. In terms of off-site analysis and the review of various applications, we evaluate the primary federal regulator's assessment of the bank's compliance with all aspects of the law and regulations, including the BSA.

§313 and §319 of the USA Patriot Act amended the BSA to prohibit U.S. financial institutions from maintaining accounts in the U.S. for foreign shell banks and require recordkeeping for certain foreign correspondent accounts. To comply with this regulation, financial institutions need to conduct enhanced due diligence to ensure it knows the owners of the account relationship and the activity in the account corresponds to the U.S. bank's expectations for that relationship.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

August 13, 2013

Honorable Patrick McHenry
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Chairman McHenry:

Thank you for your letter enclosing questions subsequent to testimony by staff of the Federal Deposit Insurance Corporation at the Committee's April 16, 2013 hearing titled, "Who is Too Big to Fail. Does Dodd-Frank authorize the government to break up financial institutions?"

Enclosed are our responses. If we can provide further information, please let us know. The Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to Questions from the Honorable Patrick McHenry
by the
Federal Deposit Insurance Corporation

Q1: Section 165(d)(4) of the Dodd-Frank Act appears to refer to two concepts for purposes of determining whether a living will is deficient: "credibility" and "facilitating an orderly resolution under bankruptcy." In your opinion, is there a distinction between those terms? If so, please explain the meaning of each term.

A1: As Mr. Osterman indicated in his answer to this question at the hearing, read literally the statute suggests that there are two standards with respect to a plan, one as to its "credibility" and one as to whether it would "facilitate orderly resolution under the Bankruptcy Code," although they are clearly closely related. As further indicated by Mr. Osterman, an example of the former might be whether the plan impermissibly relies on the provision of extraordinary support from the United States or a foreign government, while an example of the latter would be whether resolution under the Bankruptcy Code could be achieved without an adverse impact on financial stability in the United States and without resort to the FDIC's special powers under Title II of the Dodd-Frank Act. (See Osterman Transcript, pp. 97-98.) In any event, while 165(d)(4) may be read to suggest two distinct concepts, the ultimate requirement is clear that under 165(d)(4)(B), a deficient plan must be revised to demonstrate that the plan is credible and would result in the orderly resolution under the Bankruptcy Code.

Q2: Does Section 165(d)(5) require the Federal Reserve and the FDIC to impose restrictions or heightened standards and/or divestitures after a company fails to timely submit an acceptable living will, or is that decision purely discretionary?

A2: The statute does not require the FRB and FDIC to impose such restrictions, but those are important authorities that can be used to ensure firms develop resolution plans that are credible and would result in the orderly resolution under the Bankruptcy Code or make the structural changes necessary to achieve this objective.

Q3: Does a financial company have a right to judicial review of an action by the Federal Reserve and the FDIC under Section 165(d)(5)? If so, what would be the standard of review?

A3: In general, pursuant to the Administrative Procedure Act, judicial review is available for a final agency action, under a standard of whether the action was arbitrary or capricious. For issues arising under Section 165(d), a financial company's ability to obtain judicial review, and the applicable standard of review, would be determined based upon the same well-established principles that protect the rights of private parties with respect to administrative action by the government. It is worth noting that the process under Section 165(d) necessarily involves extensive discussion between the agencies and the financial company, and there may be a range of possible interim decisions by the agencies during that process that might not constitute "final agency action."

Q4: In response to a question from Chairman McHenry asking whether the Federal Reserve and the FDIC considered a firm's liquidity when reviewing a resolution plan submitted under Section 165(d), the following exchange occurred:

> **Mr. Wigand: Yes, [liquidity] certainly would be a factor. Absolutely.**
>
> **. . .**
>
> **Mr. McHenry: Ok. So being resolved in the Bankruptcy Code and [the] requirement within the living will [there] has to be some capacity for liquidity support as they're unwound under the Bankruptcy Code or resolved.**
>
> **Mr. Wigand: More — more specifically what is required is for the firm to outline how they will handle the liquidity management of the bankruptcy process. So specifically, you know, I — we — we aren't asking the firms to specifically identify where that liquidity support will be drawn from.**
>
> **But it's a liquidity analysis to indicate how the firm can unwind itself or go through the bankruptcy process without posing systemic consequences.**
>
> **Source: Congressional Quarterly Transcript at p. 50.**

Is the foregoing a materially accurate transcription of your testimony? If not, please state why not. If the foregoing is materially accurate, please state the reasons why the FDIC does not "ask[] the firms to specifically identify where that liquidity support will be draw[n] from." In answering this question, please state the reasons why, in the FDIC's view, the FDIC is able to determine that a living will is credible and would facilitate an orderly resolution of the company under the Bankruptcy Code in the absence of information that identifies the sources from which a company would receive liquidity support. Please detail how companies otherwise substantiate their liquidity management plans.

A4: The portion of Mr. Wigand's answer that is quoted in the excerpt is accurate. Mr. Wigand's full answer explained that the FDIC and the FRB have asked covered companies to outline a plan or process for maintaining liquidity. This information will be available to the FDIC in determining whether or not a living will is credible and could facilitate a rapid and orderly resolution under the Bankruptcy Code. The 165(d) Rule requires a strategic analysis of liquidity and funding, including a detailed description of the

> "Funding, liquidity and capital needs of, and resources available to, the covered company and its material entities, which shall be mapped to its critical operations and core business lines, in the ordinary course of business and in the event of material financial distress at or the failure of the covered company." 12 C.F.R. §381.4(c)(1)(iii).

The Guidance provided by the FRB and the FDIC for the 2013 165(d) resolution plan submissions by the covered companies that submitted their initial plans in 2012 places further emphasis on the liquidity requirements during the period leading up to and during resolution, and calls for a description of the process for arranging debtor-in-possession financing, consents to use cash collateral and/or other means of providing liquidity to the covered company's Material Entities during the bankruptcy process. In addition to that overview, covered companies have been asked six detailed questions about funding and liquidity, including funding sources and uses by legal

entity and jurisdiction, the impact of potential ring-fencing, the challenges of securing funding sources, liquidity and funding needs over time during resolution, funding requirements of each Critical Operation, and inter-affiliate funding exposures. The company would be required to describe generically the sources of liquidity that could be accessed but not the names of the specific companies that might be sources of liquidity.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

October 7, 2013

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for your letter enclosing questions from Senator Mike Crapo subsequent to the testimony by Richard Brown, Chief Economist of the Federal Deposit Insurance Corporation at the Committee's June 13, 2013 hearing entitled, "Lessons Learned from the Financial Crisis Regarding Community Banks."

Enclosed are our responses. If we can provide further information, please let us know. The Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosure

Response to questions from the Honorable Mike Crapo
by Richard Brown, Chief Economist, Division of Insurance and Research,
Federal Deposit Insurance Corporation

Q1: Academic researchers estimate that when Dodd-Frank is fully implemented, there will be more than 13,000 new regulatory restrictions in the Code of Federal Regulations. Over 10,000 pages of regulations have already been proposed, requiring more than 24 million compliance hours each year. As FDIC's Chief Economist, how are you trying to track the total compliance costs for community banks? Please share specific details.

A1: Quantifying Costs

The costs of regulatory compliance and their effect on profitability and competitiveness are frequent topics of discussion among community bankers. While our ability to quantify the costs of regulatory compliance is somewhat limited, the FDIC has undertaken a number of initiatives designed to make those costs as small as possible.

This topic was repeatedly addressed in the six Roundtable discussions hosted by the FDIC in 2012 as part of the Community Banking Initiative, and also has been a frequent topic of discussion in meetings of the FDIC's Community Bank Advisory Committee.

Notwithstanding the high degree in interest in this topic by all concerned parties, regulatory data reported through the quarterly Call Reports provide only a limited picture of bank overhead expenses. While all FDIC-insured institutions report total noninterest expenses each quarter, these expenses are not broken down into regulatory and non-regulatory components. Expressed as a percent of total assets, noninterest expenses for community banks have been flat for three consecutive years (2010-12) at 3.0 percent.

In view of the data limitations, FDIC researchers conducted interviews with nine community bankers as part of our 2012 Community Banking Study to try to better understand what drives the cost of regulatory compliance and, where possible, obtain actual financial data to better understand how regulation and supervision affects bank performance.

Most participants stated that no single regulation or practice had a significant effect on their institution. Instead, most cited the cumulative strain imposed by a number of regulatory requirements over time. Several indicated that they have increased staff over the past ten years to support regulatory compliance. Yet none indicated that they actively track compliance costs, citing the difficulties of breaking out these costs separately.

These responses from community bankers speak to the careful balance regulators must achieve when trying to measure regulatory costs. While community bankers themselves are certainly in the best position to understand their cost structure, requiring that they report more detailed data about the nature of those costs would itself impose a new regulatory burden.

Supervisory Approach

As the primary federal regulator for the majority of smaller, community institutions (those with less than $1 billion in total assets), the FDIC is keenly aware of the challenges facing community banks and we already tailor our supervisory approach to consider the size, complexity, and risk profile of the institutions we oversee.

In addition, the FDIC has implemented a number of initiatives to mitigate the compliance costs associated with new regulations, based on feedback we received from community banks during our Examination and Rulemaking Review undertaken in 2012. This effort was informed by a national conference to examine the unique role of community banks in our nation's economy and the challenges and opportunities they face and a series of roundtable discussions conducted in each of the FDIC's six supervisory regions that focused on the financial and operational challenges and opportunities facing community banks, and the regulatory interaction process.

First, as a result of comments we received, we developed a web-based tool (e-Prep) that generates a pre-examination document and information request list tailored to a specific institution's operations and business lines.

Second, we instituted a new Regulatory Calendar that alerts stakeholders to critical information as well as comment and compliance deadlines relating to changes in federal banking laws and regulations.

Third, to enhance the ability of community banks to comply with regulatory requirements without the need for outside consultants, the FDIC recently made available new online resources. A new Director's Resource Center provides links to more than a dozen new instructional videos, including a new Virtual Director's College, designed to provide valuable information and advice to bank managers and directors. (In an effort to help reduce banks' compliance training costs, we have been conducting director and banker colleges in each region for some time now.) In addition to these efforts, the FDIC includes in all Financial Institution Letters a Statement of Applicability that clarifies whether the specific rules, regulations, and guidance will apply to community banks.

The FDIC continues to conduct outreach sessions, training workshops, and symposia to provide technical training and opportunities for discussion on subjects of interest to community bankers.

Q2: Do you agree with Federal Reserve Chairman Bernanke's statement at a recent hearing that the burden of Dodd-Frank regulations falls disproportionately on small and community banks? If so, what can be done to reduce that burden?

A2: As demonstrated in the crisis of 2008, the economic costs of financial instability are enormous. Prudential regulation and supervision of depository institutions have been instituted under the Federal Deposit Insurance Act and other statutory mandates to promote financial stability and to reduce the frequency and severity of such crises.

The costs of complying with these regulatory requirements on the part of FDIC-insured institutions are not insignificant. Moreover, these costs include some that vary a great deal with

the size and complexity of the institution, and some that are relatively fixed. With regard to the latter category of fixed regulatory costs, it is true to say that they fall disproportionately on smaller institutions, which employ fewer people and have fewer financial resources that can be devoted to complying with regulatory requirements.

At the same time, there are many examples of regulatory costs and requirements that have been designed to vary with the size and complexity of the institution, and therefore, do not necessarily impose a higher cost on smaller institutions. Among these are the premiums charged by the FDIC for deposit insurance, which are based on both the size and the risk of each institution. It is worth noting that an important requirement of the Dodd-Frank Act was to broaden the assessment base for deposit insurance premiums from domestic deposits to total liabilities minus net worth. This shift, implemented by the FDIC in 2010, served to reduce the annual premiums paid by small banks (with assets under $1 billion) by about 30 percent. In addition, accommodations were made for smaller institutions when the Dodd-Frank mortgage rules were implemented. Special exemptions reduced the regulatory requirements and lowered compliance costs for smaller institutions. These exemptions were included in several key regulations, including those related to servicing, the ability-to-repay, and qualified mortgage regulations.

Nonetheless, the FDIC continues to pursue initiatives that will help to further reduce the costs of regulatory compliance on community banks, as described in the response to Question 1. These efforts recognize the potential for regulatory compliance costs to fall disproportionately on smaller institutions and include specific steps designed to help smaller institutions to minimize those costs.

Q3: In light of the FDIC's thorough report on community banks and their failures, is there a single element that we should monitor in the event of future crises?

A3: The *FDIC Community Banking Study* and the Material Loss Reviews conducted by the FDIC Office of Inspector General (OIG) both identified a collection of business strategies that proved to be especially problematic in the recent crisis and are now subject to close supervisory attention by the FDIC.

The *Community Banking Study* showed that institutions pursuing high-growth strategies–frequently through commercial real estate or construction and development lending–encountered severe problems during real estate downturns and generally underperformed over the long run. In contrast, community banks that grew prudently and that maintained diversified portfolios or otherwise stuck to their core lending competencies during the study period exhibited relatively strong and stable performance over time.

According to Material Loss Reviews conducted by the OIG in the aftermath of bank failures, losses at community banks during the crisis were most often caused by management strategies of aggressive growth and concentrations in commercial real estate loans, including notably, concentrations in acquisition, development and construction loans, coupled with inadequate risk management practices in an environment of falling real estate values that led to impairment losses on delinquent and nonperforming loans. Another common characteristic of failed banks was reliance on volatile brokered deposits as a funding source.

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Office of Legislative Affairs

October 7, 2013

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for your letter enclosing questions subsequent to testimony by Doreen Eberley, the Federal Deposit Insurance Corporation's Director of Risk Management Supervision at the hearing entitled "Private Student Loans: Regulatory Perspective" before the Committee on June 25, 2013. Enclosed are our responses.

The FDIC is continuing its efforts to clarify to the institutions it supervises that, for borrowers experiencing difficulties, including those with student loan debt, prudent workout arrangements are generally in the best long-term interest of the lender and the borrower. On July 25, 2013, the FDIC, jointly with the other federal banking agencies,[1] issued a statement to the industry encouraging loan modifications and restructurings for student loan borrowers experiencing financial difficulties.[2] This statement also clarifies that existing interagency guidance, the *Uniform Retail Credit Classification and Account Management Policy*,[3] already permits this activity.

If you have further questions, the Office of Legislative Affairs can be reached at (202) 898-7055.

Sincerely,

(b)(6)

Eric J. Spitler
Director
Office of Legislative Affairs

Enclosures

[1] The Board of Governors of the Federal Reserve System (FRB) and the Office of the Comptroller of the Currency (OCC).
[2] See http://www.fdic.gov/news/news/press/2013/pr13065.html.
[3] See http://www.fdic.gov/regulations/laws/rules/5000-1000.html#fdic5000uniformpf.

Response to Questions from
the Honorable Tim Johnson
by the Federal Deposit Insurance Corporation

Q1 – Troubled Debt Restructuring:
Many lenders have noted that they cannot modify loans because they do not want the modification to be considered a troubled debt restructuring, or TDR, for accounting purposes. Can you describe when a loan modification is a TDR and what role your agency plays in interpreting the accounting standard? Mr. Lyons' testimony stated that "under GAAP a bank must recognize a loan modification for a financially troubled borrower that includes concessions as a TDR, with appropriate loan loss provisions if impairment exists. The designation of a loan as TDR does not prohibit or impede a bank's ability to continue to work with the borrower." Ms. Eberley's testimony noted that "[p]otential or actual treatment as a TDR should not prevent institutions from proactively working with borrowers to restructure loans with reasonable modified terms....[t]he FDIC encourages banks to work with troubled borrowers and will not criticize IDI management for engaging in prudent workout arrangements with borrowers who have encountered financial problems, even if the restructured loans result in a TDR designation." Can you describe how designation of loans as TDR factors into an institutions' allowance for loan and lease losses (ALLL), and what role the ALLL plays in calculation of a financial institution's minimum regulatory capital? How would the Basel III rules change the treatment of ALLL in the capital calculation, if at all? Please also describe any other impact designating a loan as TDR has on an institution's balance sheet.

A1: U.S. generally accepted accounting principles (GAAP) state that a restructuring or modification of a debt constitutes a troubled debt restructuring (TDR) if the creditor, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that the creditor would not otherwise consider were it not for the debtor's financial difficulties.[1] When the terms of a loan are modified, an institution must apply judgment and consider all relevant facts and circumstances when determining (1) whether the debtor is experiencing financial difficulties and (2) whether the institution has granted a concession. The relevant accounting principles also include guidance on making these determinations.[2]

With regard to the FDIC's role in interpreting accounting standards, pursuant to Section 37 of the Federal Deposit Insurance Act, the accounting principles applicable to the regulatory reports insured banks and savings associations file with the federal banking agencies – the Consolidated Reports of Condition and Income (Call Report) – must be "uniform and consistent with" GAAP. The Call Report instructions issued by the Federal Financial Institutions Examination Council (FFIEC), of which the FDIC is a member, summarize GAAP for TDRs. These instructions and other supervisory and reporting materials issued by the FDIC, including through the FFIEC, also provide additional interpretational and application guidance on accounting and reporting for TDRs that is intended to be consistent with GAAP. Examples include the interagency Policy Statement on Prudent Commercial Real Estate Loan Workouts and the FDIC's Supervisory Insights article Accounting for Troubled Debt Restructurings. These and other additional guidance have been developed in response to

[1] See Accounting Standards Codification Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors.
[2] Ibid.

questions from bankers and examiners and are intended to promote consistency in the accounting and reporting of TDRs.

Under GAAP, a loan restructured as a TDR is an impaired loan. All impaired loans, including TDRs, must be measured for impairment in accordance with accounting principles.[3] The principles sets forth measurement methods for estimating the portion of an institution's overall ALLL attributable to impaired loans, including those that are TDRs and those that are not. Many loans whose terms are modified in TDRs will already have been identified as impaired loans before they are restructured. In these situations, because the allowances for these individually impaired loans would be measured under accounting principles both before and after they have been modified, their allowances likely would not materially change as a result of the restructurings. The remainder of an institution's overall ALLL would be determined in accordance with additional accounting principles as appropriate.[4] For regulatory reporting purposes, an institution also would be expected to follow the relevant Call Report instructions and supervisory guidance when determining the appropriate level for its overall ALLL. In addition, according to accounting principles,[5] a credit loss on a loan, including a TDR, which may be for all or part of the loan, should be deducted from the ALLL and the related loan balance should be charged off in the period when the loan is deemed uncollectible.

For regulatory capital purposes, an institution's ALLL generally is included in tier 2 capital up to a maximum of 1.25 percent of gross risk-weighted assets. Gross risk-weighted assets are reduced by the amount of any excess over the 1.25 percent limit when determining total risk-weighted assets. However, for an advanced approaches institution under the Basel II capital rules (in general, an institution with $250 billion or more in consolidated total assets or $10 billion or more in consolidated total on balance sheet foreign exposure as well as a subsidiary of such an institution) after its parallel run period, the treatment of the ALLL for purposes of measuring regulatory capital depends on its level in relation to expected credit losses, as defined in the rule. If the ALLL and other "eligible credit reserves" are less than an institution's total expected credit losses, in general, 50 percent of the shortfall is deducted from tier 1 capital and 50 percent of the shortfall is deducted from tier 2 capital. If the ALLL and other "eligible credit reserves" are greater than an institution's total expected credit losses, the institution may include the excess amount in tier 2 capital up to a maximum of 0.6 percent of risk-weighted assets.

The Basel III rules do not change the percentage limit on the amount of an institution's ALLL that can be included in tier 2 capital. However, the measurement of risk-weighted assets was revised under Basel III. As a result, the application of the 1.25 percent of total risk-weighted assets limit on the amount of an institution's ALLL eligible for inclusion in tier 2 capital would cause the institution's eligible ALLL under Basel III to be different than under the current regulatory capital risk-weighting rules. For an advanced approaches institution that has completed the parallel run process and has been approved to apply these approaches, the Basel III rules require the entire amount by which the ALLL and other "eligible credit reserves" are less than an institution's total expected credit losses to be deducted from common equity tier 1 capital.

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[3] ASC Subtopic 310-10, Receivables – Overall.

[4] ASC Subtopic 450-20, Contingencies – Loss Contingencies, and ASC Subtopic 310-30, Receivables – Loans and Debt Securities Acquired with Deteriorated Credit Quality.

[5] ASC Subtopic 310-10

Q2 – Guidance:
Mr. Lyons stated in his testimony that the OCC issued supplemental guidance to its examiners in 2010 interpreting the Uniform Retail Classification and Account Management Policy (Retail Policy) in the context of private student lending. However, that guidance is not available to private student lenders, borrowers, or any other market participants. Does the OCC plan to make this guidance public or otherwise provide information to the institutions that it regulates on supervisory expectations for managing forbearance, workout, and modification programs? Mr. Vermilyea stated in his testimony that the Retail Policy is "timeless." The Retail Policy was revised in 2000, which superseded a 1999 revision, which in turn revised a policy from 1980. The private student loan market quadrupled from 2001 to 2008 and just as rapidly declined through 2012. Given the marked changes in the student loan market since publication of the Retail Policy in 2000, what criteria do the agencies, either individually or through the Federal Financial Institutions Examination Council, use to determine when it is appropriate to revisit retail credit policy? When would it be appropriate to provide guidance to private student lenders regarding supervisory minimum expectations?

A2: The FDIC supervises private student loan (PSL) lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other consumer loans. The interagency Uniform Retail Credit Classification and Account Management Policy (Retail Credit Policy) applies to student loans as it does to other unsecured personal loans. The Retail Credit Policy provides principles-based guidance to insured depository institutions on classifying retail credits for regulatory purposes and establishing policies for working with borrowers experiencing financial problems.

Some confusion has recently been expressed in the industry regarding regulatory policies for providing flexibility for institutions to modify or restructure PSLs. In response, the FDIC, jointly with the FRB and OCC, issued a statement on July 25, 2013, to their respective supervised institutions to clarify and reiterate that the interagency Retail Credit Policy applies to PSLs, allows broad flexibilities to institutions specifically related to working with PSL borrowers experiencing financial difficulties, and permits workouts, deferrals, and renewals to help borrowers overcome temporary financial difficulties. The statement emphasizes that our supervised institutions should be transparent and make sure that borrowers are aware of the availability of workout programs.

Response to Questions from
the Honorable Mike Crapo
by the Federal Deposit Insurance Corporation

Q1. The FDIC testified that it would provide guidance on private student loans in the near future.

- **What factors contributed to the FDIC's decision to publish new guidance specific to private student loans?**
- **Did the FDIC consult any other prudential banking regulator or the CFPB in developing the expected guidance?**

A1: The FDIC considered information, including recent Consumer Financial Protection Bureau (CFPB) reports regarding student loans, and consulted with other federal banking agencies about the Retail Credit Policy. The FDIC, jointly with other federal bank regulators (FRB and OCC), recently issued a statement applicable to the banks each agency supervises to reiterate and specifically clarify that the current regulatory guidance provides institutions with broad flexibilities to help student loan borrowers overcome temporary financial difficulties, including through prudent extensions, deferrals, and rewrites. We also informed the CFPB that we would be issuing such a statement.

Response to Questions from
the Honorable Sherrod Brown
by the Federal Deposit Insurance Corporation

Q1: In the years leading up to the financial crisis, the Student Loan Asset Backed Securities (SLABS) market experienced unprecedented growth. SLABS issuance grew to more than $16 billion annually to feed investor demand for these securities. To increase volume, higher dollar value loans were made to a greater range of borrowers before being securitized. Multiple witnesses noted that the loans still held in securitized trusts may have fewer modification and other refinance opportunities than those retained on a bank's balance sheet, further limiting options for borrowers and raising the risk of default.

a. **Where applicable, what percentage of student loans originated by institutions regulated by your agency and still in repayment is held in securitized trusts? What percentage is held on banks' balance sheets?**

A1a: About 25 percent of the estimated $150 billion in private student loans (PSLs) outstanding are in securitization trusts; most of the remainder are on banks' balance sheets, although some state-sponsored agencies and other organizations securitize or hold small amounts of PSLs.

b. **Is there a difference in the performance of loans that have been securitized and those that are held directly on a bank's balance sheet?**

A1b: As noted in Ms. Eberley's testimony, specific data on PSLs are not reported separately on the Call Reports, which banks file quarterly. Student loans are a fairly small portion of aggregate consumer lending and relatively few banks make these types of loans. Data on PSLs, like other unsecured installment loans, are reported under the broader loan category "other loans to individuals." The PSL lenders supervised by the FDIC reported past due rates (30 or more days delinquent) just under 3 percent of total student loan balances and annual charge-offs just over 1.5 percent at the upper end of the range.

In June of this year, Moody's Investors Service reported that the average default rate for securitized private loans (equivalent to the regulatory charge-off rate) fell from 5.0 percent during first quarter 2012 to 4.0 percent during first quarter 2013. Despite this improvement, the default rate is still about 50 percent higher than it was prior to the recession. Moody's also reported that the 90-day and over delinquency rate dropped slightly from 2.5 percent in first quarter 2012 to 2.4 percent during first quarter 2013.

In his testimony, Mr. Chopra stated that mortgage and student loan borrowers may have more difficulties working out a modification or forbearance when those loans have been securitized, but fewer barriers exist for student loan borrowers than existed in the mortgage market.

c. **What additional barriers to forbearance and modifications exist for private student loan borrowers whose loans were securitized?**

d. How are contract conditions for SLABS different from conditions for mortgage-backed securities?

A1c & d: As discussed in Ms. Eberley's testimony, for securitized loan pools, payment restructuring and modification options may be limited by the terms of the securitization governing documents. As a result, when repayment difficulties arise, the borrower will be dealing with the servicer, not the original lender. Although student loan borrowers whose loans were securitized may face barriers to forbearance and modification, the barriers could be less onerous and less explicit than those that existed with the private-label mortgage-backed securities originated in the period leading up to the financial crisis.

The type of loan and nature of the servicing arrangement appear to more directly impact modification and forbearance options for distressed student loan borrowers. Federal student loan (FSL) servicing standards are uniform and modifications are statutorily based and, therefore, available regardless of whether they are securitized. The standards for PSL servicing vary by servicer, as do options for modification. FSLs typically offer more forbearance and modification options than PSLs.

Generally, the governing securitization documents for PSLs do not explicitly limit modifications to loans underlying securitizations, but the structure of the securitization may influence how servicers apply forbearance and modification. For example, the interest payments that are received from the underlying loans that are over and above the interest payments to bondholders are considered "excess spread," which is a form of overcollateralization for the securitization that provides protections to bondholders. Servicers may be less willing to provide modifications if doing so would extract more cash flow from the underlying loans to maintain excess spread. Another common structural feature that the PSL asset-backed securities and private-label mortgage-backed securities share is a senior/subordinate structure, where cash flows are diverted to senior bondholders when certain performance triggers are breached, such as cumulative default rates. The senior/subordinate structure can influence modification and forbearance activities, as discussed in the testimony.

In contrast, the contractual obligations for private-label mortgage-backed securities issued during the financial crisis created more explicit barriers to modification. For example, certain governing securitization documents contained restrictions on the amount of underlying mortgage loans that could be modified (frequently limited to 5 percent of the outstanding pool). Other governing documents, namely the Pooling and Servicing Agreements, often required the servicer to take actions that would be in the best interest of the investors and required servicers to determine whether a modification would benefit the securitization on a present-value basis. Additionally, mortgage-backed securities had certain restrictions under the real estate investment trust (REIT) structure. These are just some of the barriers to modification faced by mortgage borrowers whose loans were securitized in private label mortgage-backed securities.

e. What would be required to offer borrowers with securitized loans the same options that can be afforded to borrowers whose loans were not securitized?

A1e: The FDIC continues to seek solutions to challenges in the student lending area. The FDIC, jointly with the FRB and OCC, recently issued a statement to the institutions we supervise to clarify that we support efforts by banks to work with student loan borrowers and our current regulatory guidance permits this activity. In addition, the statement makes clear FDIC-supervised institutions should be transparent in their dealings with borrowers and make certain that borrowers are aware of

the availability of workout programs and associated eligibility criteria. Additionally, the FDIC has formed a working group to engage various stakeholders, including private student loan lenders and consumer groups to determine whether other enhancements are needed.

Q2. As a voting member agency of the Financial Stability Oversight Council, I am interested in your views on how you assess whether an entity would meet the criteria to be designated a systemically important financial institutions (SIFI). Specifically, given its extremely large footprint in servicing Direct, FFELP, and private student loans, what would be the broader impact on consumers and markets if SLM Corp. (Sallie Mae) were to fail?

A2: Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Financial Stability Oversight Council (FSOC) to determine that a nonbank financial company shall be supervised by the FRB and shall be subject to prudential standards, in accordance with Title I of the Dodd-Frank Act, if the FSOC determines that material financial distress at the nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the nonbank financial company, could pose a threat to the financial stability of the United States. The final rule and the interpretive guidance describe the manner in which the FSOC intends to apply the statutory standards and considerations, and the processes and procedures that the FSOC intends to follow, in making determinations under section 113 of the Dodd-Frank Act. While the FDIC does not comment on open and operating institutions, the impact of any major consumer loan servicer would depend on market conditions at the time and the company's ability to sell or transfer its balance sheet components and servicing platforms.

Q3. In October 2012, the Consumer Financial Protection Bureau issued a report about problems service members face when utilizing benefits guaranteed by federal law, even on government-guaranteed student loans. Your agency supervises institutions with FFELP portfolios.

a. Have you focused on these portfolios in your examinations?

A3a: The FDIC's compliance examination process is risk-focused, including its review of student loans and related practices. As part of that review, examiners assess compliance with federal laws designed to protect servicemembers. Examples of federal laws that provide special protections to servicemembers are the Servicemembers Civil Relief Act (SCRA) and the Military Lending Act (MLA). These laws could involve student loans as well as other types of loans. SCRA and MLA compliance is an important examination priority for the FDIC given the potential for consumer harm. SCRA is included in the scope of all compliance examinations conducted by the FDIC. Through the risk-based examination process, examiners communicate this emphasis to our supervised banks during the review of the bank's compliance management system and transaction testing.

Additionally, the FDIC's examination process also includes a review of consumer protection laws and regulations under its authority to the extent those rules are applicable to PSL and Family Federal Education Loan Program (FFELP) portfolios. However, the Truth-in-Lending Act exempts loans made, insured, or guaranteed under title IV of the Higher Education Act of 1965, which includes FFELP portfolios. In general, the regulatory review of an institution's policies and practices with

regard to student lending encompasses the bank's origination and servicing aspects for PSLs and focuses on servicing with regard to the federally guaranteed student loans.

b. To what extent have you determined that servicemembers are victims of unfair or deceptive practices as it regards to student loan benefits?

A3b: The FDIC takes enforcement actions to address violations of the SCRA, MLA, section 5 of the Federal Trade Commission Act (Section 5) regarding unfair and deceptive acts and practices, and other applicable laws and regulations, including those that involve an institution's policies and practices affecting student loans. Since January 2012, the FDIC has addressed SCRA violations (generally) in 55 examinations and FDIC-supervised institutions have reimbursed, pursuant to enforcement actions, a total of approximately $154,000 to 358 servicemembers for violations of SCRA.

c. Are you confident that your supervised institutions are in compliance with the SCRA?

A3c: Based on our compliance examination procedures and processes, which include SCRA compliance reviews, we believe that most of the institutions we supervise comply with the SCRA. Where we find violations, we take appropriate corrective action.

The primary responsibility for compliance with the SCRA rests with an institution's board and management. The FDIC's compliance examination process assesses how well a financial institution manages compliance with federal consumer protection laws and regulations starting with a top-down, comprehensive evaluation of the compliance management system (CMS) used by the financial institution to identify, monitor, and manage its compliance responsibilities and risks, including those associated with the SCRA. The goal of a risk-focused, process-oriented examination is to direct resources toward areas with higher degrees of risk.

The FDIC specifically examines its institutions for compliance with the SCRA, using transaction sampling and other techniques. Through our policies, guidance, and examination procedures, the FDIC communicates to our supervised institutions the importance of SCRA compliance. The FDIC may initiate informal or formal corrective action when an insured depository institution is found to be in an unsatisfactory condition, based on unfair or deceptive acts or practices. Violations of consumer protection laws and regulations and/or a bank's failure to maintain a satisfactory CMS may also result in these types of corrective action.

d. To what extent have you shared these results with the Department of Education and the Department of Justice?

A3d: Subject to the limitations of the Right to Financial Privacy Act (RFPA) and FDIC regulations regarding the sharing of confidential supervisory information, 12 C.F.R. Part 309 (Part 309), the FDIC shares examination information with other federal financial institution regulators and with the Department of Justice (DOJ). DOJ has exclusive enforcement authority over criminal violations and has concurrent authority over violations of federal fair lending laws and the SCRA. If the FDIC uncovers evidence that parties over which DOJ has exclusive or concurrent authority may have violated these laws, the FDIC shares with the DOJ relevant information related to these potential violations to the extent permitted by the RFPA, Part 309, and interagency memoranda of

understanding. Because the Department of Education (DOE) does not have enforcement jurisdiction over financial institutions, such examination information is not typically shared with DOE.

For compliance examinations, the review of loan servicing by an institution focuses on ensuring that the agreement is consistent with governing laws and is implemented as agreed to avoid any SCRA or Section 5 violations.

Q4. The CFPB's May 2013 report, Student Loan Affordability: Analysis of Public Input on Impact and Solutions, raised concerns about the effect of unsustainable levels of student debt. Heavy student loan burdens not only deplete available resources but can also limit the career opportunities of young graduates who must earn salaries that can repay tens or hundreds of thousands of dollars in debt. And, if borrowers fall behind the resulting damage to their credit can further limit access to financing for a home, car, or even daily purchases. Homebuilders and mortgage originators have already noted a decrease in the volume of home purchases by young people, and practitioners in careers that may offer less compensation, including public service and family medicine, have noted that young people are now gravitating toward more lucrative careers to pay back large volumes of debt.

a. Has your agency observed differences in home loans, auto loans, and other extensions of credit to young borrowers?

A4a: Insured depository institutions report information on their financial condition and operations in their quarterly Call Report filings. All data, including information on loans, are reported in aggregate and do not contain any demographic or other identifying characteristics.

b. Given the risks associated with student loans, which are typically underwritten without an extensive borrower credit history, and the relatively more secure, collateralized loans made for homes, cars, and other consumer products, how do you project that the rising burden of student debt will impact the balance sheets of the institutions that you regulate in the long term?

A4b: Institutions supervised by the FDIC hold about $14 billion in PSLs, representing less than 10 percent of the estimated $150 billion in PSLs outstanding. This amount represents a very small portion of the $14.4 trillion in total industry assets and $7.7 trillion in total loans outstanding. PSL originations are currently about $8 billion per year.

The FDIC supervises PSL lenders using the same framework of safety and soundness, and consumer protection rules, policies, and guidance, as for other loan categories. We expect insured institutions to prudently underwrite PSLs and comply with outstanding rules and guidance. PSLs typically are required by originators to have a co-signer. In 2011, over 90 percent of these loans were co-signed. According to TransUnion, the 90-day and over delinquency rate for PSLs was 5.33 percent as of March 2012.

c. In your experience, do the private student lenders you regulate extend, or offer to extend, other forms of credit to borrowers of private student loans? How do incentives for customer service and sound financial practices change for private student lenders that do not offer a full suite of financial products?

A4c: One of the larger lenders that the FDIC supervises offers a variety of credit products, including credit cards, personal loans, and home loans. Specific data quantifying the number of accounts and balances of private student loans holding multiple products by this institution are not publicly available.

Another large lender which originates PSLs does not offer other forms of credit to PSL borrowers.

As a general matter, financial institutions' approaches to customer service and financial practices are motivated by a desire to grow and maintain a strong and well-regarded business. Moreover, as mentioned under our response to question 8, we examine the institutions we supervise for safety and soundness and for compliance with all applicable laws, rules, and guidance.

Q5. Your testimony cited OCC guidance issued in 2010 as the standard that regulators use when determining the soundness of bank's decision to work with a troubled borrower. The guidance states that once repayment has begun "private student loans should not be treated differently from other consumer loans except in cases where the borrower returns to school." It further states the loan modifications should be considered for "long-term hardships" and may "temporarily or permanently" reduce interest rates to lower payments but should not include terms that "delay recognition of the problem credit."

How often does each of the private student lenders that you supervise engage in loan modifications for borrowers who are in long-term hardship situations? How often does each of the lenders grant additional forbearance beyond the six month introductory period?

A5: The FDIC's testimony cited the interagency Retail Credit Policy, which provides significant flexibility for institutions to offer prudent workout arrangements tailored to their PSL portfolios and borrower circumstances. In particular, the Retail Credit Policy states that it is the institution's responsibility to establish its own policies for workouts suitable for their portfolio. There is nothing barring FDIC-supervised institutions from engaging in workouts, and many institutions offer various types of workout options. Repayment options are disclosed in application or solicitation materials as well as in the promissory note. Each institution has its own policies that establish how the bank will work with borrowers who are facing financial challenges.

The institutions we supervise do not usually publicly disclose the full scope of modification and restructuring options available. Nonetheless, the two largest FDIC-supervised institutions that offer PSLs described their features and borrower benefits in their respective letters to the CFPB, both dated April 8, 2013, responding to the Request for Information Regarding an Initiative to Promote Student Loan Affordability (Docket No. CFPB-2013-0004).

Q6. In your testimony, you described that institutions should constructively work with private student loan borrowers to conduct modifications in a safe and sound manner. Given that loan modifications might increase the net present value of certain troubled loans, how does your agency plan to increase the pace of loan modification activity among its supervised institutions?

A6: The FDIC encourages the institutions we supervise to work with borrowers who are unable to meet the contractual payments on their loans. We have communicated to banks during on-site examinations, through written guidance, and at outreach events that prudent workout arrangements are generally in the best long-term interest of both the bank and the borrower, and that examiners will not criticize banks for engaging in prudent workout arrangements, even if it results in adverse asset classifications or TDR accounting treatment.

We believe the Retail Credit Policy provides institutions with the flexibility needed to help borrowers overcome temporary financial difficulties through extensions, deferrals, renewals, and re-writes of closed-end loans, which include student loans. To emphasize this point, the FDIC, along with the FRB and OCC, recently issued a statement to the banks we supervise to clarify that we support efforts by banks to work with student loan borrowers and that our current regulatory guidance permits this activity.

Q7. Please provide any interpretive guidance (e.g. for use by examiners, supervised institutions) on the Uniform Retail Classification and Account Management Policy that is specific to private student loans. Describe how your interpretation differs from the guidance used by other prudential regulators.

A7: The federal financial institution regulatory agencies strive to consistently apply the Retail Credit Policy. On July 25, 2013, the FDIC, jointly with the FRB and the OCC, issued a statement encouraging banks to work prudently with student loan borrowers who are experiencing financial difficulties.

Q8. What is your supervisory approach when conducting examinations of federal and private student loan servicing activities? What are the risk factors that you look for? Do you [have] publicly-available manuals and guidance that cover student loan servicing? Have you utilized complaints submitted to the CFPB and the Department of Education to scope your exams?

A8: The FDIC supervises PSL lenders using the same framework of safety and soundness and consumer protection rules, policies, and guidance as for other loan categories. In addition to the examination scope and procedures described in Ms. Eberley's testimony, the FDIC reviews loan servicing activities, in particular, for safety and soundness and consumer compliance issues. Safety and soundness concerns include those related to the bank's valuation of its servicing rights (assets) and adherence to governing loan servicing documents. In general, financial institutions engaged in servicing activities, including student loan servicing, should have policies and procedures, operational support, and appropriate audit and other quality controls to ensure performance under servicing agreements.

The FDIC's compliance examination process assesses how well each financial institution manages compliance with federal consumer protection laws and regulations. In general, our examinations for compliance with the Fair Debt Collection Practices Act, Equal Credit Opportunity Act, and Section 5 of the Federal Trade Commission (FTC) Act, include review of distressed loans, including student loans, to ensure equal treatment, adherence to debt collection requirements, and that no unfair or deceptive acts or practices are involved in attempting to collect debts from distressed borrowers.

The FDIC's regulatory assessment of the supervised institution's compliance with the various consumer protection laws and regulations typically includes review of consumer complaints, pending litigation, the oversight and use of third-party servicers, due diligence on the schools the institutions work with to provide student loans (e.g., reputation, accreditations, for-profit/not-for-profit), marketing practices, and the institution's policies and procedures. These procedures apply to student loans as well as other consumer loans.

Consumer complaints play a key role in the detection of consumer protection risks, including those involving student loan issues. Examiners review various sources of complaint information, such as the CFPB, FDIC, FTC, institutional, and various media sources. The FDIC's Consumer Affairs Branch continues to monitor and identify potential areas of concern through the complaint investigation process. In analyzing and collecting information about how these products may impact consumers, we are able to see the impact these new products may have on consumers.

Q9. Compared to Direct Loans, it is generally more cumbersome for federal student loan borrowers to enroll in income-based repayment programs. Many institutions you supervise have significant FFELP holdings. How would you generally assess the ability of your supervised entities to make borrowers aware of and successfully enroll them in income-based repayment options?

A9: Not all FDIC-supervised banks have FFELP holdings, choosing instead to sell their existing FFELP portfolios. One of the major FDIC-supervised student lenders relies on affiliates to service its FFELP loan portfolio. This institution communicates to its customers, making them aware of repayment options through an interactive website that offers information regarding student loan applications, loan repayment advice, and forbearance options, among other things.

Q10. Your testimony focused heavily on forbearance as a method of relief for private student loan borrowers. But the volume and terms of private student loans issued in the years leading up to the financial crisis indicate that many of these loans may not be sustainable even after forbearance periods. The Consumer Financial Protection Bureau's July 2012 report documented a 400 percent increase in the volume of private student loan debt originated between 2001 and 2008, and 2008 originations surpassed $20 billion. The report also shows that, from 2005 to 2008, undergraduate and graduate borrowers of private student loans took on debt that exceeded their estimated tuition and fees, and in some years more than 30 percent of loans were made directly to students with no certification of enrollment from their academic institution. The heavy debt burden that was created in these few years is not just unsustainable by dollar volume, but also in loan terms. Loans were often variable rate loans with initial interest rates ranging from 3 percent to more than 16 percent.

a. Given these extremely unfavorable loan terms that were made to a larger number of borrowers, presumably including more students from limited financial means, do loans originated between 2001 and 2008 comply with your standards for safety and soundness?

A10a: Many borrowers who have student loan debt have FSLs and PSLs, as the rising cost of education often required additional borrowing to supplement college savings, scholarships, and grants used to pay for higher education. However, some mechanisms, such as extending loans only for

accredited educational programs and directly transmitting the funds to the school, that were in place to prevent overlending to an individual were circumvented during the years leading up to the recent financial crisis. As mentioned in our response to question 8, the FDIC examines banks for safety and soundness and consumer compliance concerns, and would be critical if objectionable conditions or practices are found.

b. How would refinancing the highest-cost loans to reflect borrowers' current characteristics affect the soundness of a regulated institution's balance sheet in the short and long term?

A10b: FDIC supervised institutions routinely offer new or renewed loans and, for variable rate loans, periodically adjust the loan rate, based on current market rates. In general, financial institutions actively manage the asset and liability mix of their balance sheet. Based on market-based pricing and other balance sheet management strategies used by financial institutions, as well as the small overall volume of PSLs held by banks, we do not expect refinancing of PSL loans to have a material impact on the balance sheet condition of the banks that we supervise.

Q11. Recently, SLM Corp. announced that it would make significant changes to its corporate structure. As the prudential regulator of Sallie Mae Bank, what is your view on these changes?

A11: The FDIC does not comment publicly on open banks it supervises. Published reports indicate that SLM Corporation plans to divide its existing businesses into two, separate, publicly traded entities that would each initially be owned by its existing shareholders. It is expected the separation, if completed, would be effected via a tax-free distribution of the holding company's common stock to Sallie Mae's shareholders.

Response to Questions from
the Honorable Joseph Manchin
by the Federal Deposit Insurance Corporation

Q1: In rural towns across the country, there is a chronic shortage of primary care health professionals. Not just doctors, but nurses and others. According to the American Medical Association, student debt may be a barrier to practicing in underserved communities.

This problem extends beyond health professionals. I hear from West Virginians across my state that the best teachers are retiring and that poorer districts are having a tough time bringing in young people to take their places.

So many rural families want their kids to go to college, but they worry about the impacts of high levels of student loan debt?

In your opinion, how will rural areas survive without critical professions like doctors, nurses, and teachers? What are you doing to make sure that the burden of student debt isn't disproportionately shouldered by rural areas?

A1: PSLs issued by financial institutions help individuals, who might not otherwise have the resources, to obtain a college education and the subsequent benefits associated with a college degree, both financial and nonfinancial. At the time a student loan is made, it is without regard to where future employment opportunities may be located.

As the primary regulator of small community banks, the FDIC understands the unique financial challenges in rural areas. Rural areas in particular struggle to attract and retain young professionals. The FDIC, jointly with the FRB and OCC, recently issued a statement encouraging banks to work constructively with student loan borrowers experiencing financial difficulties, and clarifying that our current regulatory guidance permits this activity.

Q2: It does not make any sense that, under our current system, students are forced to pay high interest rates on federal student loans when everyone else in the economy benefits from low borrowing costs on everything else. And if we don't act by July 1st, every federal loan will have an interest rate of at least 6.8% in 2013, while T-bill rates stay near historic lows.

Not only would moving to a market-based rate allow students to benefit from cheaper borrowing when everyone else can, I expect that PSL lenders would, in order to remain competitive, lower their rates as well. Under the current system, private lenders know that we have created artificial benchmarks for these rates, so private lenders can always keep their rates unnecessarily high.

How do you believe that implementing a market-based rate for federal loan programs would affect the private loan market? Wouldn't allowing federal rates to fall during times of cheap borrowing—such as today—force private borrowers to lower their interest rates to remain competitive?

A2: In general, students exhaust other financial options, such as grants and FSLs, before applying for PSLs, which are issued by financial institutions. Rates for the two types of student loans – FSLs and PSLs – are determined through different processes. PSLs have a market-driven rate, which reflects the supply and demand for funds, whereas FSLs have rates currently set by statute. The rates charged on loans are set by individual institutions to cover funding and overhead expenses and reflect a risk premium on the loans granted based on the risk profile of the student borrower and cosigner, if any. PSLs are unsecured (no collateral protection) and expose the institution to risk of loss for the entire outstanding loan balance in default. Loan rates for PSLs are set to reflect this risk and are already at market rates. Therefore, it is unlikely that a change in a market-based rate for federal loans to substantially affect PSLs.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

MARTIN J. GRUENBERG
CHAIRMAN

November 6, 2013

Honorable Tim Johnson
Chairman
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Johnson:

Thank you for the opportunity to respond to questions submitted by Senator Crapo, Senator Menendez, Senator Brown, and Senator Warren subsequent to my testimony at the hearing on "Mitigating Systemic Risk Through Wall Street Reforms" before the Senate Banking Committee on July 11, 2013.

Enclosed are my responses for the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-3888 or Eric Spitler, Director of Legislative Affairs, at (202) 898-7140.

Sincerely,

(b)(6)

Martin J. Gruenberg

Enclosure

Response to Questions from
The Honorable Mike Crapo
By the Federal Deposit Insurance Corporation

Q1: In late 2011, the agencies issued a highly complex and lengthy regulatory proposal to implement the Volcker rule. In February of this year, Chairman Bernanke testified that while regulators have made a lot of progress on the rule, the issues slowing the process "are finding agreement and closure among the different agencies..." When can we expect the final rule? What are the reasons for a delay?

A1: The Volcker Rule rulemaking involves the bank regulatory agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (the agencies). The agencies received more than 18,000 comment letters on the Volcker Rule proposal, including hundreds that were very detailed and highly technical. We are committed to carefully considering all views expressed during the comment process as we finalize the rule. The agencies are striving to have the rule completed by year end 2013.

Q2: Your agencies published a short guide for smaller, less complex institutions so they can understand and implement the final Basel III rule. Both of your agencies, together with the FRB, took additional steps to analyze and mitigate the burden of the proposed rule on community banks before promulgating final rules. What steps is your agency taking to ensure that its bank examiners and regional office staff properly interpret and apply the Basel III regime for community banks versus larger banks?

A2: Internally, the FDIC is holding training sessions for examination and other key supervisory staff on the interim final capital rule. To date, we have trained regional specialists who serve as points of contact on Basel III in our six regional offices (New York, Atlanta, Dallas, Kansas City, Chicago, and San Francisco) and hosted a training conference call with capital markets subject matter experts in our field office locations. We have established an internal website for FDIC examiners and staff where we are providing critical information and training materials on Basel III.

The information on our public website includes the interagency community bank guide, an expanded community bank guide developed by the FDIC, and instructional videos. We held outreach sessions for bankers in our six regional offices in August, and the FDIC hosted a national call on August 15, 2013, to review common questions on the interim final rule raised during outreach sessions. The national call was advertised to financial institutions during outreach sessions and through a Financial Institution Letter and to FDIC examination and supervisory staff through a global email.

Formal assessment of FDIC examiner training is underway to ensure the curriculum sufficiently reflects the new interim final capital rule. On an interagency basis, the FDIC participates on the Federal Financial Institutions Examination Council (FFIEC) course development teams, and the FFIEC is reviewing training updates that will be required to reflect and educate examination staff on the new capital rules.

Q3: On July 9th the FDIC board approved the Basel III rules on interim basis and, together with the FRB and the OCC, issued a proposed rule to increase the leverage ratio for the eight largest banking organizations beyond the Basel III levels. Should banks below the $700 billion threshold worry about the trickle-down effect of the proposed approach?

A3: The proposed enhanced supplementary leverage ratio would apply to banking organizations with $700 billion or more in total consolidated assets or $10 trillion or more in assets under management. It was intentionally focused on the eight most systemically significant financial institutions and not on smaller or less complex institutions that do not present the same degree of systemic risk.

Q4: The FDIC's proposal calls for a supplementary leverage ratio of 5% for large bank holding companies and 6% for the banks that are owned by those holding companies. The rules proposed by the FDIC would apply to 8 largest U.S. banks and exceed standards set by the Basel III international accord. Are European regulators considering similar requirements for large EU-based banks since most of the 10 largest banks in the world are based out of Europe? If European regulators are not considering similar standards for their large banks, what effect would FDIC's proposal have on the competitiveness of the U.S. banks abroad?

A4: While Basel III establishes an international leverage ratio for the first time, there is no indication at this time that other jurisdictions would propose leverage standards beyond the minimum provided in the Accord. However, U.S. banks have long been subject to prompt corrective action standards that include minimum requirements based on a leverage ratio, while European banks until now have not been subject to such requirements. Historically, U.S. banks have fared very well relative to their European counterparts despite (or perhaps because of) being subject to higher capital standards. The financial crisis in Europe has been exacerbated in large part due to weakness in the banking sector. As such, we believe a strongly capitalized banking sector will benefit banking organizations and the economy.

Q5: Institutions with non-bank assets greater than $250 billion filed their resolution plans last year and must now provide a second, more comprehensive version of the living will by October 1st. How can we know that these living wills will work in the first place? What are top three significant obstacles identified by regulators in the first round of living wills that warrant additional scrutiny?

A5: Under the framework of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act), bankruptcy is the preferred option in the event of the failure of a Systemically Important Financial Institution (SIFI). To make this objective achievable, Title I of the Dodd-Frank Act requires that all bank holding companies with total consolidated assets of $50 billion or more, and nonbank financial companies that the Financial Stability Oversight Council (FSOC) determines could pose a threat to the financial stability of the United States, prepare resolution plans, or "living wills," to demonstrate how the company could be resolved in a rapid and orderly manner under the Bankruptcy Code.

The FDIC and the Federal Reserve (the Agencies) review the 165(d) plans and may jointly find that a plan is not credible or would not facilitate an orderly resolution under the Bankruptcy Code. If a plan is found to be deficient and adequate revisions are not made, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on growth, activities, or operations of the company, including its subsidiaries. If a company does not comply with these requirements within two years, the FDIC and the Federal Reserve, in consultation with the FSOC, can order the company to divest assets or operations to facilitate an orderly resolution under the Bankruptcy Code.

Eleven companies submitted initial resolution plans in 2012. Following the review of the initial resolution plans, the Agencies provided additional Guidance to companies to assist in the preparation of their 2013 resolution plan submissions. The Agencies extended the filing date to October 1, 2013, to give the firms additional time to address the Guidance.

The Agencies will be evaluating how each resolution plan addresses a set of benchmarks outlined in the Guidance that pose the key impediments to an orderly resolution. The benchmarks are as follows:

- Multiple Competing Insolvencies: Multiple jurisdictions, with the possibility of different insolvency frameworks, raise the risk of discontinuity of critical operations and uncertain outcomes.
- Global Cooperation: The risk that lack of cooperation could lead to ring-fencing of assets or other outcomes that could exacerbate financial instability in the United States and/or loss of franchise value, as well as uncertainty in the markets.
- Operations and Interconnectedness: The risk that services provided by an affiliate or third party might be interrupted, or access to payment and clearing capabilities might be lost.
- Counterparty Actions: The risk that counterparty actions may create operational challenges for the company, leading to systemic market disruption or financial instability in the United States.
- Funding and Liquidity: The risk of insufficient liquidity to maintain critical operations arising from increased margin requirements, acceleration, termination, inability to roll over short term borrowings, default interest rate obligations, loss of access to alternative sources of credit, and/or additional expenses of restructuring.

Response to Questions from
The Honorable Robert Menendez
by the Federal Deposit Insurance Corporation

Q1: Over the last few months, we've seen reports in the press of so-called "regulatory capital trades," in which regulated financial institutions have purchased credit protection (often using credit default swaps) from unregulated entities (often SPVs, hedge funds, or other entities formed offshore to avoid regulation) in order to reduce the amount of capital they need to hold against an investment on their books. In effect, these trades are transferring risk from regulated institutions that are subject to capital requirements to unregulated entities that are not subject to capital requirements, and creating exposure of the regulated institution to a potential default by the unregulated entity.
If this story sounds familiar, it should – this is strikingly similar to what we saw happen with AIG before the financial crisis. These trades are transferring risk from regulated and supervised financial institutions to unregulated corners of the market, where it can build and concentrate without monitoring or supervision by regulators.

The Basel Committee has partly addressed this issue by calling for banks to properly account in their capital calculations for the costs of credit protection they purchase. But does this proposal do enough to address concerns about regulatory arbitrage and systemic risk accumulating all over again through "shadow banking?" Are you concerned about these "regulatory capital trades," and what steps are you taking to monitor and address these arrangements?

A1: The FDIC does not condone "regulatory capital trades" that mask a bank's risk position and result in an overly optimistic portrayal of its underlying capital strength. Our examiners are aware of the issue and will scrutinize such activities during on-site examinations.

In March, 2013, the Basel Committee issued a consultative paper titled "Recognising the cost of credit protection purchased," which proposes changes in regulatory capital rules intended to address some of these concerns. In addition, other regulatory initiatives will help mitigate risk concerns associated with these trades. For example, many of these "regulatory capital trades" are conducted via over-the-counter derivatives. Going forward, these trades will be subject to margin requirements as well as heightened capital standards.

Response to Questions from
The Honorable Sherrod Brown
By the Federal Deposit Insurance Corporation

Q1: A critical element of the proposed new Basel leverage ratio is the definition of the denominator (the assets subject to the leverage requirement). A denominator definition that permits too many bank commitments to remain off the balance sheet and uncapitalized could undermine the benefits of a higher leverage ratio requirement.

A) Have the banking agencies made a quantitative examination of the change in bank assets subject to the leverage requirement that will be created by the new Basel leverage rules?

B) Could you please inform us, for the six largest U.S. banks and bank holding companies, the approximate amount of total assets that would be counted for the denominator of leverage capital requirements under the following definitions of assets:

- **a. U.S. GAAP**
- **b. IFRS accounting**
- **c. The proposed Basel leverage ratio definition**

C) What factors are most important in determining the difference between GAAP and IFRS accounting and the proposed Basel leverage ratio definition? What is the total amount of the difference accounted for by:

- **a. Changes in off-balance sheet treatment of credit commitments that are not derivatives contracts.**
- **b. Changes in derivatives netting and offset rules.**

To the degree possible, please include breakdowns of the impact of the relevant sub-changes in each of these areas, as well as written explanations of the areas in the Basel leverage ratio definition that account for the differences.

A1: The banking agencies have analyzed the quantitative impact of the leverage ratio proposal. A discussion of this analysis is included in the Enhanced Supplementary Leverage Ratio notice of proposed rulemaking. In summary, our analysis indicates that, on average, the proposed supplementary leverage ratio denominator would be 1.43 times larger than total assets reported in the denominator of the longstanding U.S. leverage ratio, which is based upon U.S. GAAP.

According to Federal Reserve regulatory reporting data (FR Y-9C), which are calculated in accordance with U.S. GAAP, the largest holding companies reported total assets of: $2.2 trillion for JP Morgan; $2.1 trillion for Bank of America; $1.8 trillion for Citigroup; $1.3 trillion for Wells Fargo; $0.9 trillion for Goldman Sachs; and $0.7 trillion for Morgan Stanley. These and other U.S. institutions are not required to report total assets under International Financial Reporting Standards (IFRS). Accordingly, we are unable to provide the quantitative estimates of

GAAP-IFRS differences requested in your letter. In general terms, however, an important difference between the two frameworks, especially from the perspective of financial institutions active in derivatives, is that while both frameworks allow netting of derivatives under certain circumstances, in the case of IFRS, those circumstances are more limited.

It is important to note that the leverage ratio included in the Basel III agreement is calculated in a manner that is not dependent on a particular bank's accounting framework. The Basel agreement follows principles more similar to U.S. GAAP in certain areas (e.g. derivatives netting) and more similar to IFRS in other areas (e.g. the treatment of certain collateral). For example, the proposed supplementary leverage ratio denominator follows the U.S. GAAP approach for netting derivatives and securities lending and borrowing transactions. However, the proposed supplementary leverage ratio denominator includes several add-ons that are not part of U.S. GAAP or IFRS: 1) a potential future-exposure amount for derivatives; 2) off-balance sheet commitments; and 3) 10 percent of unconditionally cancellable commitments (e.g. unused credit card lines).

Q2: The new leverage ratio proposals mandate a leverage ratio of 6 percent for large bank subsidiaries, but a lower 5 percent ratio for the overall holding company. What policy justification is there for this distinction between the bank and the holding company?

A2: These levels are structurally consistent with the current relationship between the generally applicable leverage ratio requirements for insured depository institutions (IDIs) and bank holding companies (BHCs). Under the existing rules, IDIs must maintain a 5 percent generally applicable leverage ratio to be well capitalized for prompt corrective action (PCA) purposes, whereas BHCs must maintain a minimum 4 percent generally applicable leverage ratio under separate BHC regulations. The new standards are more stringent than the current 5 percent well-capitalized standard under PCA with respect to the generally applicable leverage ratio due to the higher calibration and inclusion of additional items in the denominator.

Response to Questions from
The Honorable Elizabeth Warren
By the Federal Deposit Insurance Corporation

Q1: Has your agency done any studies on the costs and benefits of allowing banks to book derivatives in depositories?

A1: Experience has shown that certain types of derivatives can be used to improve risk management while other types of derivatives activity appear to have elevated risks within banks or the financial system as a whole. For example, interest rate swaps have been used for more than a decade to help institutions manage interest rate risk as part of their asset liability management process. On the other hand, banks' credit default swaps activity has sometimes had the effect not of hedging risk but of elevating risk, both to individual institutions and the financial system. For example, large banks experienced significant losses on credit derivatives in 2007 and 2008; these pro-cyclical losses appear to have amplified rather than hedged the risks facing these institutions at the time (see also the table provided in the response to Question 8).

Q2: A number of derivatives experts, including Frank Partnoy and Satyajit Das, contend that a large percentage of complex OTC derivatives, including credit default swaps, are not used for commerce but for economically unproductive activities such as gaming accounting and tax rules or hiding losses. Have you ever taken a large sample of derivatives transactions to see if these charges have validity? If the charges are accurate, in what ways would you change your views about derivatives regulation?

A2: Derivatives markets are undergoing major reforms as the result of domestic regulations and international mandates. The *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act) requires significant reforms of derivatives activities. For example, under the Dodd-Frank Act certain derivatives must be cleared, margin will have to be exchanged between derivatives counterparties, certain derivatives (such as uncleared credit default swaps that are not hedging risk) will be pushed out of IDIs, and the Volcker Rule will limit proprietary trading in derivatives positions. These reforms are designed to manage systemic risk and should reduce the incentives to use derivatives to support unproductive activities such as those described by certain derivatives experts.

Q3: Treasury Lew recently stated, "if we get to the end of this year and we cannot with an honest straight face say that we have ended Too Big To Fail, we're going to have to look at other options." Do you agree?

A3: Effectively addressing "Too-Big-To-Fail" will require regulators to implement a broad range of reforms. These include additional capital requirements, enhanced prudential supervision, the reforms of derivatives regulation described in the answer to the previous question, the resolution planning procedures under Title I of the Dodd-Frank Act and the orderly liquidation authorities in Title II of the Act. While we have made significant progress on many

of these reforms, there is still work to do to finalize some of them and some will require ongoing attention in the years to come.

The FDIC has devoted significant effort and resources to carrying out our new authorities under Titles I and II. The living will requirements of Title I of Dodd-Frank Act and the resolution authority of Title II of the Act are critical components to addressing "Too-Big-To-Fail." These provisions are intended to allow for these firms to fail and be resolved in a rapid and orderly manner, without systemic disruption. Implementation of these provisions will impose accountability on systemically important financial institutions by permitting the removal of culpable management and imposing losses on shareholders and creditors of a failed company, without risk to taxpayers.

The FDIC expects to continue to make significant progress on key elements of addressing "Too-Big-To-Fail" before the end of the year. For example, the revised resolution plans for the largest, most complex financial institutions were submitted on October 1, 2013, and will be subject to review under the standards of the Dodd-Frank Act. Determination of appropriate actions to be taken will be considered by the FDIC and the Federal Reserve. In addition, the FDIC expects to release a description of the FDIC's strategy for handling the orderly liquidation of a systemically important financial institution for public comment by the end of the year. Also, the FDIC will be engaged in ongoing discussions with our international counterparts about planning and coordination regarding the failure of a large institution with international operations.

Q4: The agencies have proposed increasing the leverage ratio for very large bank holding companies to 5 percent, and for depositories to 6 percent. These "supplementary" ratios are calculated using U.S. GAAP accounting measures. This means that total on-balance-sheet assets include only the net value of derivatives positions. If derivatives were accounted for under IFRS, which limits derivatives netting, then their total assets would be substantially higher. (See, for example, the analysis of the quantitative impact of different accounting rules done by ISDA: at http://www2.isda.org/functional-areas/research/studies/.)

a. **Does the proposed increase in the leverage ratio do more than bring the U.S. leverage requirement roughly into line with the 3 percent leverage ratio that will be applied by EU regulators to all banks?**

A4a: The Basel Committee's agreement on the leverage ratio includes a definition of the leverage ratio denominator that is independent of a bank's accounting framework. Therefore, a bank that calculates a leverage ratio under the Basel agreement will obtain the same result regardless of the accounting framework it uses for reporting purposes. Thus, the recently proposed U.S. leverage requirements for large, systemically important institutions are, in fact, significantly more stringent than the international three percent standard, irrespective of the accounting framework. If European Union regulators adopt the three percent leverage ratio agreed upon by the Basel Committee, they will likely do so according to the Basel Committee's agreement, which (consistent with U.S. GAAP and, in many circumstances, IFRS) records derivative positions on a net basis.

b. Should the GAAP/IFRS difference and implications be detailed and addressed in the rulemakings? If not, why not?

A4b: The proposed rule focused on the numerical value of the supplementary leverage ratio, thereby maintaining continuity with the definition of that ratio in the revised capital rules the agencies published in July 2013. The measurement of derivatives exposure is an important issue that the agencies continue to analyze with the Basel Committee. The Basel Committee recently issued a consultative paper that proposes changes to the measure of exposure used in the international leverage ratio framework, including for derivatives. As noted in the proposed rule, if the Basel Committee finalizes changes to the leverage exposure measure, the agencies would consider the appropriateness of such changes for purposes of U.S. regulation.

c. Have you compared the proposed leverage ratios to the losses experienced by banking institutions during the financial crisis?

A4c: As noted in the preamble to the proposed rule, the agencies' analysis suggests that the 3 percent supplementary leverage ratio standard would not have materially constrained leverage had it been in effect during the years leading up to the crisis. This suggests that the 3 percent leverage standard is an insufficient safeguard. With the proposed 6 percent supplementary leverage ratio for covered insured banks, the increase in stringency of the leverage standards for these institutions would be similar to the increase in stringency of their risk-based capital requirements in the revised capital rules published in July 2013.

d. Why is there a distinction between the leverage ratio for bank holding companies and depositories?

A4d: The one percentage point difference in the proposed rule between the supplementary leverage requirements for banks and bank holding companies is structurally similar to the current generally applicable leverage requirements, which also incorporate a 1 percentage point difference between insured banks and bank holding companies.

Q5: Under 12 USC 1818(e), federal banking agencies may remove "institution-affiliated parties" from participation in the affairs of an insured depository when they directly or indirectly violate banking laws or regulations. Were officers or directors of any bank that was party to the mortgage servicer settlements removed because they directly or indirectly participated in the violations that led to the settlements? If no officer or director was removed, can you explain why?

A5: The October 2010 announcement by Ally Financial, Inc. (AFI) (the parent of Ally Bank (Midvale, Utah), Residential Capital, LLC (ResCap) and GMAC Mortgage, LLC) that certain of its subsidiaries (ResCap and GMAC Mortgage) had engaged in certain foreclosure practices, now commonly referred to as "robo-signing," prompted the FDIC's review of the mortgage servicing practices and procedures of GMAC Mortgage, an affiliate of Ally Bank. The Federal Reserve Bank of Chicago joined the FDIC's review of GMAC Mortgage. The federal banking

agencies subsequently initiated a horizontal review of the nations' 14 largest mortgage servicers. The Department of Justice (DOJ) and a task force of the State Attorneys General conducted a parallel review of these practices. As a result of these reviews, the federal banking agencies entered into Consent Orders with the entities they supervised and the DOJ and State AGs entered into Consent Judgments with many of these same entities.

The FDIC is the primary federal supervisor of Ally Bank. Ally Bank, like many other depository institutions, engages third parties to perform mortgage servicing. The horizontal review of the major servicers determined that they had engaged in unsafe and unsound mortgage servicing practices, and the FDIC determined that Ally Bank had failed to properly supervise and adequately oversee its third party servicers. Accordingly, the FDIC ordered Ally Bank to take corrective action to rectify its oversight deficiencies. The required corrective action is detailed in the Consent Order entered into by AFI, ResCap, GMAC Mortgage and Ally Bank with the Board of Governors of the Federal Reserve System and the FDIC. The effect of this Order is to require the bank to ensure that its affiliated servicer takes corrective measures to fully address the deficiencies identified in the interagency review. Both the bank and its affiliates have made substantial progress in complying with the requirements of the Consent Order. However, the facts regarding Ally Bank and its institution affiliated parties documented during the horizontal review were not sufficient to satisfy the misconduct, effect and culpability statutory standards required to support any removal and prohibition action under Section 8(e).

Q6: How do you audit large bank IT systems to determine potential systemic risk?

A6: Where the FDIC is the primary federal regulator of a large institution, FDIC examiners conduct information technology (IT) and operations risk management examinations to assess the effectiveness of a bank's IT risk identification, measurement, and mitigation practices. IT and operations risk management examinations are conducted concurrently with safety and soundness examinations. At the conclusion of an examination, the bank is assigned a composite rating that reflects the results of the IT and operations risk management evaluation (which assesses the effectiveness of the audit, management, development and acquisition, and support and delivery components). The composite rating is based on a scale of 1 to 5, with 1 representing the highest rating and least degree of supervisory concern and with 5 representing the lowest rating and highest degree of supervisory concern. The higher degree of supervisory concern, the more frequently the institution is examined. In addition to full-scope examinations, FDIC examiners may conduct interim visitations to assess whether the bank is addressing deficiencies noted in the most recent full-scope examination.

The Federal Financial Institutions Examination Council publishes an *IT Examination Handbook* that addresses topics such as Information Security, Supervision of Technology Service Providers, and Business Continuity Planning. The Handbook describes specific IT risks and includes examination procedures used to assess a bank's compliance with federal laws, regulations, and supervisory guidance. The procedures in the Handbook are more granular for larger, more complex banks. For example, the Information Security and Business Continuity Planning examination procedures are structured as Tier I and Tier II. Tier II procedures are targeted at larger, more complex institutions and are more in-depth.

Where the FDIC is not the primary federal regulator, FDIC examiners and specialists monitor potential risks associated with information technology systems' capabilities and controls at such firms through ongoing interaction with the primary federal regulator and other regulators of such institutions. This ongoing interaction includes obtaining continuous feeds of supervisory findings from other regulators and internal risk reporting from the institutions as well as working on-site at the firms alongside the other regulators, including direct participation in certain supervisory reviews and activities. The FDIC also obtains information about an institution's management information systems through the review of institution-prepared resolution plans at both the consolidated level and at individual large banks within the organization. Such activities allow the FDIC to develop an independent assessment of the risk profile of such institutions and determine whether appropriate corrective actions are being taken to reduce unreasonable risk.

Q7: The U.S. Chamber of Commerce has called for a trade review of the Volcker Rule, alleging that the rule violates trade agreements. Has your agency done any legal analysis of whether pending or prior trade pacts would vitiate its ability to impose higher capital requirements on SIFIs?

A7: We are not aware of any trade agreements that diminish our statutory authority to impose higher capital requirements on SIFIs, either through a rulemaking or by order on a case-by-case basis. The federal banking agencies have considerable discretion to impose capital requirements under the prompt corrective action (PCA) requirements of section 38 of the Federal Deposit Insurance Act, the International Lending Supervision Act, as well as various provisions of the Dodd-Frank Act (including sections 165 and 171). Historically, the risk-based and leverage capital requirements have served as the basis for determining an institution's capital category under PCA.

Q8: Has your agency performed any studies or prepared any estimates of the profit subsidy banks derive from carrying derivatives in depositories?

A8: We have not attempted to directly estimate the profit subsidy from derivatives activities in IDIs. However, the revenue generated from derivatives activities in IDIs is publicly disclosed. The following table is based on the Office of the Comptroller's latest quarterly derivatives report:

Bank Trading Revenue $ in millions	YTD 2013	2012	2011	2010	2009	2008	2007	2006	2005
Interest Rate	4,985	16,966	15,949	6,162	14,470	1,778	8,110	4,617	4,466
Foreign Exchange	6,320	5,267	5,061	9,081	5,595	11,363	6,973	7,953	6,219
Equity	1,753	2,044	2,894	2,052	1,061	(2,016)	2,881	4,952	3,108
Commodity & Other	646	1,182	1,441	618	1,460	1,451	294	1,265	593
Credit	1,059	(6,843)	5,062	4,605	6	(13,001)	(12,704)	0	0
Total Trading Revenues	**14,762**	**18,617**	**30,408**	**22,518**	**22,592**	**(425)**	**5,555**	**18,786**	**14,385**

Note: Effective in the first quarter of 2007, trading revenues from credit exposures are reported separately, along with the four other types of exposures.
Note: Trading revenue is defined here as "trading revenue from cash instruments and off balance sheet derivative instruments."
Note: Numbers may not sum due to rounding
Note: YTD 2013 is as of 2Q 2013
Source: OCC Derivative Reports, from Call Reports, Schedule RI