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January 24, 2020

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington D.C. 20429

RE: Request for Information on a Framework for Analyzing the Effects of FDIC Regulatory Actions (RIN 3064-ZA13)

Dear Mr. Feldman:

The Independent Community Bankers of America (ICBA)[1] welcomes the opportunity to respond to the Federal Deposit Insurance Corporation's (FDIC) request for information ("ROI"), seeking comment on its framework for analyzing the impact of regulatory actions. The FDIC's stated intention is to improve its analysis of regulatory actions to ensure they minimize the regulatory burden born by the public and banking industry, as well as to ensure these policies achieve their stated goals efficiently and effectively.

Background

The FDIC is subject to several statutory mandates which require periodic assessment of the costs and benefits associated with its regulations. The Regulatory Flexibility Act (RFA)[2] requires such measures be taken to ensure that regulatory actions do not place a significant economic burden on small institutions and, if so, to examine alternatives which mitigate any adverse impact. Yet, the key phrases, "significant impact" and "small institutions", are not defined within the Act and subject to inconsistent interpretation. Additionally, agencies can comply with these mandates via quantitative *or* qualitative assessments, and in some cases, waive the requirements entirely. This is troublesome for community bankers who wonder whether new rules undergo a genuine and rigorous evaluation process before they are proposed.

[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5 trillion in assets, nearly $4 trillion in deposits, and more than $3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.
[2] Hoskins, Sean M., and Marc Labonte. "An Analysis of the Regulatory Burden on Small Banks." (2015).

Similarly, as per the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) of 1996, members of the Federal Financial Institutions Examination Council (FFIEC) are required to conduct a decennial evaluation of their regulations to identify those which are burdensome, outdated, or otherwise unnecessary for insured depository institutions. While well-intentioned, FFIEC members including the FDIC have failed to produce meaningful changes for community banks under EGRPRA, resorting to meager tweaks in regulation and the occasional removal of a duplicative rule. Such legislation underscores the importance, and need for improvement, of cost-benefit analyses such as those employed by the FDIC; these exercises provide quantitative evidence for regulators and their constituents to distinguish between effective and ineffective regulations.

When conducting regulatory analysis of prospective rulemaking, the FDIC draws guidance from OMB Circular A-4, which provides an overview of the objectives and outcomes that should be evaluated when considering a particular rule. Broadly, there are three principles which should be addressed in every undertaken regulatory analysis: an explanation for how the actions required yield the expected benefits, establishment of a baseline from which to examine the costs and benefits of an "alternative" via new regulation, and the identification of externalities which may result from the proposed rule categorized as additional costs or benefits.

The Marginal Cost of Regulation

According to a study by the Conference of State Bank Supervisors (CSBS)[3] economies of scale are a major factor in compliance costs. Small banks were reported to have compliance costs double that of the largest banks. This context is critical to understanding the true costs of a proposed regulation; on its own the rule could seem harmless but when supplementing other rules touching similar topics or affecting the same peer group of institutions, the overall impact can be duplicative, expensive, and arduous. This is especially true for community banks, which do not have the resources to spend on additional compliance-related costs and are often less likely to engage in practices requiring greater regulation or oversight. Therefore, it is important that cost-benefit analyses of prospective regulations affecting community banks consider their potential to have a snowball effect on compliance.

[3] 2019 National Survey of Community Banks. Conference of State Bank Supervisors, 2019, 2019 National Survey of Community Banks.

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One example of this is the cumulative regulatory impact of Basel III, which was created with the express purpose of addressing the prior flaws of Basel I, II, and II.5 in addition to making capital rules more risk sensitive. While the complexity of Basel III may have improved the quality and quantity of capital for the large banks, it has conversely imposed international capital standards on community banks that are both illogical and costly. When conducting cost-benefit analyses in the future, the FDIC should ascribe both an individual and cumulative cost to prospective rules akin to a nominal and real measure of Gross Domestic Product (GDP). While primarily serving as a check on the costs of prospective regulations, the FDIC could also utilize these estimates to identify areas of overregulation and make the argument for repealing certain rules based on quantitative evidence demonstrating their unnecessary costs.

Competitive Advantage of Compliance

The FDIC could also address the consequences of proposed rulemaking on market competition, specifically the competitive advantages of the financial institutions under its purview. For example, in the same study by CSBS[4] community banks face significant compliance costs with regard to the Community Reinvestment Act (CRA). If the FDIC proposed a change to CRA examination requirements, then its cost-benefit analyses should account for the impact that such changes would have on community banks, as well as other players within the financial services sector including credit unions and nonbanks, which do not undergo such examinations and would have a competitive advantage over competitors at a local, state, and national level via lower non-interest expenses.

The FDIC already tracks changes in market competition through a Herfindahl-Hirschman Index (HHI) constructed from its Summary of Deposits (SOD). While HHIs are primarily employed to analyze market concentration due to mergers and acquisitions, expanding their coverage through estimates or additional data would make this measure an appropriate starting point from which the FDIC could track changes in competitive advantage among more players within the financial services industry, and factor them into their cost-benefit analyses on proposed regulation. Some potential uses may include an average estimated change in HHI within the cost-benefit analysis of a proposed regulation, as well as a post-implementation review of institutions' HHI examining changes in market share and competitive advantage due to the FDIC's rulemaking.

[4] 2019 National Survey of Community Banks. Conference of State Bank Supervisors, 2019, 2019 National Survey of Community Banks.

Long-Term Productivity Outlook

The FDIC should also examine the impact of proposed rulemaking on industry productivity and include such estimates within their cost-benefit analyses. Analyzing changes in productivity, the quotient of an industry's outputs to inputs, due to a prospective regulation would provide a more comprehensive understanding of its long-term consequences. For example, a proposed regulation could increase non-interest expenses which would result in decreased productivity unless offset by costs to labor or services. Additionally, a proposed regulation could force institutions to adapt by changing their practices, such as employing more technology for complex operations, which would increase long-term productivity. Productivity among FDIC-regulated institutions could also have spillover effect into other sectors of the economy closely related to financial services.

The FDIC already produces a measure of productivity for financial institutions under its purview known as "Efficiency" which is calculated as bank assets per employee. While using the number of bank employees as the denominator is a perfectly acceptable way to calculate productivity, the input lacks any differentiation in labor quality. In other words, credit for a change in assets per employee is equally distributed between the CEO and Bank Teller, when in reality, contributions from both individuals to a bank's total assets are likely different. Using hours would be a better way of tracking micro-level operational changes to a bank that could be linked to changes in the tasks required, such as compliance with a regulation. An industry-level measure of productivity for commercial banks using hours is already published by the Bureau of Labor Statistics (BLS), which would be a good baseline from which to construct future estimates[5].

Conclusion

To conclude, the American financial services landscape is shifting rapidly, which means FDIC regulations must also evolve in a manner that enables institutions to thrive. By conducting cost-benefit analyses that quantify the incremental impact of a proposed regulation, identify the beneficiaries, and estimate their long-term impact, the FDIC will be better prepared to implement rules which complement industry growth while providing responsible oversight in accordance with its public mission as a federal regulator.

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[5] Royster, Sarah E. "Improved Measures Of Commercial Banking Output And Productivity." *Monthly Labor Review*, July 2012.

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ICBA appreciates the opportunity to comment on the FDIC's current framework for analyzing the impact of its regulatory actions. If you have any questions or would like any additional information, please do not hesitate to contact me by email at Noah.Yosif@icba.org.

Sincerely,

/s/

Noah Yosif
Assistant Vice President for Economic Policy & Research

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