# OVERSIGHT OF FINANCIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, DIVERSITY, AND ACCOUNTABILITY OF DEPOSITORY INSTITUTIONS DURING THE PANDEMIC

## HEARING

BEFORE THE

## COMMITTEE ON FINANCIAL SERVICES

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# CONTENTS

# OVERSIGHT OF FINANCIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, DIVERSITY, AND ACCOUNTABILITY OF DEPOSITORY INSTITUTIONS DURING THE PANDEMIC

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**Thursday, November 12, 2020**

U.S. House of Representatives,
Committee on Financial Services,
*Washington, D.C.*

The committee met, pursuant to notice, at 12 p.m., via Webex, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Sherman, Meeks, Clay, Green, Cleaver, Perlmutter, Himes, Foster, Beatty, Vargas, Gottheimer, Lawson, Tlaib, Porter, Axne, Casten, McAdams, Wexton, Lynch, Adams, Dean, Garcia of Illinois, Garcia of Texas, Phillips; McHenry, Lucas, Posey, Luetkemeyer, Stivers, Barr, Hill, Emmer, Loudermilk, Mooney, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, and Taylor.

Chairwoman Waters. The Financial Services Committee will come to order. Without objection, the Chair is authorized to declare a recess of the committee at any time.

Before we begin today's hearing, I want to remind Members of a few matters, including some required by the regulations accompanying House Resolution 965, which established the framework for remote committee proceedings.

First, Members are reminded to keep their video function on at all times, even when they are not being recognized by the Chair. Members are also reminded that they are responsible for muting and unmuting themselves, and to mute themselves after they have finished speaking. The staff has been instructed not to mute Members, except when a Member is not being recognized by the Chair, and there is inadvertent background noise.

Members are further reminded that they may only attend one remote hearing at a time. So if you are participating today, please remain with us during the hearing. Members should try to avoid coming in and out of the hearing, particularly during the question period.

If, during the hearing, Members wish to be recognized, the Chair recommends that Members identify themselves by name so as to facilitate the Chair's recognition. I would also ask that Members be patient as the Chair proceeds, given the nature of the online platform the committee is using.

Finally, Members are reminded that all House rules relating to order and decorum apply to this remote hearing.

Today's hearing is entitled, "Oversight of Financial Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions During the Pandemic."

I will now recognize myself for 4 minutes to give an opening statement.

On November 3rd, America decisively rejected President Trump, his harmful policies, and his dangerous rhetoric. The American people have given President-elect Biden a mandate to govern and reverse the harmful policies of the Trump Administration, including the many actions that several of our witnesses have taken to deregulate Wall Street. This mandate is entirely consistent with recent State referendums in which voters in red States embraced progressive economic policies. For example, in Nebraska, voters banned usury, approving a Statewide interest rate cap of 36 percent. In Florida, voters approved a $15-an-hour minimum wage. It is clear that Americans want a financial and economic system that works for them and not against them.

I was inspired by the words of President-elect Biden on how he wants to unify the country. As ever, I stand ready to work with Members on both sides of the aisle, and the incoming Biden Administration, on reforming our financial system so that consumers and investors have the protections they need.

President-elect Biden has already begun the work of building a better future for our nation. On Monday, we established a coronavirus task force, showing how seriously he is working on this virus. Make no mistake, the pandemic continues to take a terrible toll. There have been over 10.2 million U.S. cases, and over 239,000 people have lost their lives to the virus. We are now seeing over 100,000 new U.S. cases a day.

From the beginning of this pandemic, I have urged regulators to focus their efforts on pandemic response, and halt rulemakings unrelated to addressing the crisis. I am very concerned that regulators have nonetheless issued numerous harmful regulatory rules in the midst of the ongoing pandemic. For example, the Office of the Comptroller of the Currency (OCC) issued a harmful rule that badly undermines the Community Reinvestment Act (CRA). Regulators have also moved to weaken the Volcker Rule, which prevents banks from gambling with taxpayer money. There have also been a number of troubling rulemakings to weaken capital and other prudential requirements for the nation's largest banks.

The last thing the nation needs during this crisis are actions from regulators that harm communities and make our financial system insecure and less stable. I am putting our witnesses on notice that I will be working with the Biden Administration to roll back these rules. Financial regulation, and the approach to diversity and inclusion in this country, are going to change for the better. With the historic election of this country's first woman and person of color to serve as Vice President, it is already changing for the better.

Under my leadership, the committee has led the way on diversity and inclusion, establishing an historic Subcommittee on Diversity and Inclusion, aptly chaired by Representative Beatty. Under

President Biden's leadership, our financial regulators will and must be diverse. We are emerging from the dark days of the Trump Administration into the dawn of a new progressive America where pro-consumer and pro-investor policies will always be first on the agenda.

The Chair now recognizes the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry, for 4 minutes for an opening statement.

Mr. McHenry. Thank you. And I want to thank the regulators for being here.

I would also note for the Chair that I don't see the election outcome as this vote for the woke left policy agenda of House progressives; it was anything but that. We have more Republicans in the next Congress in the House of Representatives because, quite frankly, the far left went so far. And so, while you may have had some successes in the election, I don't think it is the wide endorsement of a far left policy agenda that the Chair noted.

In fact, what I would note is that in the middle of this pandemic, instead of taking political potshots, we should make a serious, concerted effort to have a serious conversation in this committee, like we have not had in the midst of this pandemic. And I think it is a very, very sad thing that we have not been more focused on financial stability, and the important work that these regulators who are before us today have been about this year.

So with that, I would like to thank our witnesses for being here today, and I want to commend them for the work that they have put in to address the effects of the pandemic on our financial system. They have done a fantastic job, a wonderful, fantastic job, and they all should be commended for the work that they have put in, tacked decisively at the start of this crisis to provide the necessary certainty and clarity for our financial system.

Your quick implementation of the provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act from March forward provided financial institutions and consumers appropriate flexibility to accommodate the daily challenges that they faced in the midst of this pandemic. I would also encourage you to continue examining the regulations in your purview to ensure stability in the banking system.

As I have said previously and will repeat again today, our focus must be on the following: increasing testing; opening schools safely; and getting people back to work. Last week, unemployment dropped to just under 7 percent, a rapid turnaround from the April high of 14.7 percent. This is a good start. Our economy is rebounding, but more can be done, and I believe pro-growth regulations and policies are the key to sustained success. We know that modernizing and right-sizing regulations will unleash the economy and allow consumers and small businesses to flourish, and that is what you are doing, and I appreciate that work that you are about.

A big part of that is regulatory clarity. I want to thank Acting Comptroller Brooks and Chair McWilliams for their work to help bring certainty to the legal status of loans made through banking partnerships. Much of the innovation in financial services right now is happening within the context of partnerships between banks and fintech firms. Your efforts have helped bring greater definition to the regulatory and supervisory models for these partnerships.

We should also continue to examine the importance of de novo charters in rural banking. Serving banking deserts is a necessary aspect of supporting our Main Street rural small businesses. And I want to commend my colleague from Kentucky, Congressman Barr, for his work on this important issue.

Now more than ever, technology is going to play an essential role in our financial future. Innovation is important for our success. As new policies are considered, we should ensure that government is not standing in the way of private sector creativity and helping our people.

I will end where I started. The tone of this hearing does not bode well for the next Congress. We have the ability to find good bipartisan solutions to help promote a successful financial system that is inclusive and addresses the needs of the American people. Yet, my colleagues continue to choose divisiveness over bipartisanship, and that is disappointing.

I want to thank all of the witnesses for being here today and for your solid, good work in the midst of this health pandemic. Thanks so much.

Chairwoman WATERS. The Chair now recognizes the gentleman from New York, Mr. Meeks, who is also the Chair of our Subcommittee on Consumer Protection and Financial Institutions, for 1 minute.

Mr. MEEKS. Thank you, Madam Chairwoman.

As we reach the end of the 116th Congress, it is important to consider all of the accomplishments of this committee, for which I congratulate our chairwoman and all of the members of this committee.

As Chair of the Consumer Protection and Financial Institutions Subcommittee, I set out to focus my work on issues of discrimination, inequality, and the unbanked and underbanked. I spent the bulk of my time working on Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs), and thinking that a period of relative stability in a decade into the expansion that started under President Obama's leadership was a perfect opportunity to tackle these issues.

The COVID-19 pandemic and nationwide protests against police brutality and racial injustice have laid bare the structural inequalities, and, yes, discrimination across our system. I would argue that the agenda set in this committee for the 116th Congress was persistent and laid the foundation of the urgent priorities that our nation grapples with today, and it is an inflection point.

And so, therefore, I thank you, Madam Chairwoman, again, for tackling these issues, and I look forward to continuing to work with you.

Chairwoman WATERS. Thank you.

The Chair now recognizes the subcommittee's ranking member, Mr. Luetkemeyer, for 1 minute.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman.

And thank you to all of the regulators who are here today, for being here in this critical time for our nation's economy.

As you know, the pandemic caused a blanket shutdown across the country and threatened tens of millions of American jobs. But the strength of American businesses and workers responded with an astounding 33 percent increase in the GDP in the third quarter. It is clear that Americans have undergone an heroic effort to adapt to the strain and pressure of the pandemic. And with recent news of a vaccine, economic recovery is in full swing.

While this is good news, we must ensure that Congress and the regulators do not hinder the progress that the economy is making. To the contrary, regulators should enhance financial institutions' ability to aid in the economic recovery and ensure that consumers and businesses can make it to the end of the pandemic.

Many provisions in the CARES Act, including a Troubled Debt Restructuring (TDR) provision, are set to expire at the end of the year. I am very interested to hear what you, the prudential regulators, are going to allow institutions to do to keep their customers and communities afloat in this time.

With that, I look forward to discussing these matters, and I yield back. Thank you.

Chairwoman WATERS. Thank you very much.

I would now like to welcome today's distinguished panel: the Honorable Rodney Hood, Chairman of the National Credit Union Administration; the Honorable Jelena McWilliams, Chair of the Federal Deposit Insurance Cooperation; the Honorable Randal Quarles, Vice Chair of Supervision at the Board of Governors of the Federal Reserve System; and Brian Brooks, Acting Comptroller of the Currency at the Office of the Comptroller of the Currency.

Each of you will have 5 minutes to summarize your testimony. You should be able to see a timer on your screen that will indicate how much time you have left, and a chime will go off at the end of your time. I would ask you to be mindful of the timer, and quickly wrap up your testimony if you hear the chime, so we can be respectful of both the witnesses' and the committee members' time. And without objection, all of your written statements will be made a part of the record.

Chairman Hood, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE RODNEY E. HOOD, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)**

Mr. HOOD. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for the opportunity to provide an update on the safety, soundness, and diversity of federally insured credit unions and the NCUA's efforts to assist them during the ongoing COVID-19 emergency.

Our nation's credit union system was well-capitalized at the start of the pandemic, and it remains so today. With high levels of net worth and ample liquidity, this strength has allowed credit unions to adapt to the operational challenges resulting from the pandemic. Total assets in federally insured credit unions rose 15 percent over the year, ending in the second quarter of 2020 at $1.75 trillion. Credit union shares and deposits rose by nearly 17 percent, to $1.49 trillion.

Since mid-March, the NCUA has worked diligently to provide credit unions with regulatory relief and much-needed flexibility so they can continue to safely serve their member owners. We have also adjusted our examination program to protect our staff, and we all continue to work remotely and effectively.

We continue to examine for compliance with the Bank Secrecy Act and potential cybersecurity risk, helping to ensure our credit union system remains secure and resilient. We have issued 11 interagency statements and 20 guidance letters to the industry to date, helping credit unions to address emerging risk, and to implement the regulatory and statutory changes that have been made in response to the pandemic.

The NCUA has provided over $3.7 million in technical assistance to small, low-income, and minority credit unions in the form of our 2020 Community Development Revolving Loan Fund allocation, which went directly to COVID-19 assistance. The credit union system's net worth increased 6.8 percent over the year, to $182.9 billion. The aggregate net worth ratio of the system stood at 10.46 percent, well above the 7 percent statutory requirement.

The Share Insurance Fund is also strong, and the equity ratio remains well within the statutory range under the Federal Credit Union Act. Accordingly, we believe there is no need to assess a premium at this time.

Credit unions have continued to provide needed credit and financial services, with lending rising to an all-time high of $1.5 trillion in all major loan categories. Credit unions collectively extended $8.4 billion in loans under the SBA's Paycheck Protection Program (PPP), with an average loan amount of $49,000.

Like capital, liquidity is a pillar of strength and the bedrock upon which the safety and soundness of the credit union system rests. Congress' decision to increase the flexibility of, and borrowing authority for, the Central Liquidity Facility (CLF) in the CARES Act has contributed greatly to bolstering the availability of liquidity in the credit union system. Since the Act was signed into law, the NCUA has successfully encouraged natural person and corporate credit unions to join the CLF. Today, the Facility's borrowing capacity has exceeded $32 billion and provides access to nearly 80 percent of all credit unions.

I am indeed grateful that Congress provided this much-needed authority in the CARES Act. However, I respectfully request that these changes be extended for the pandemic's duration so the credit union system and the NCUA can respond effectively should the need for emergency liquidity arise.

One important lesson from 2020 is the need for greater financial inclusion. Lamentably, recent events have revealed many inequities in our society, not the least of which is that the pandemic has had a more deleterious impact on communities of color. At the NCUA, we are proud of the fact that diversity, equity, and inclusion are part of who we are and how we do business, and Section 342 of the Dodd-Frank Act has been a catalyst for growth and change. Indeed, we have made tremendous progress in this area over the last decade in terms of recruitment, employee retention, and procurement.

Since becoming the 11th Chairman of the NCUA, I have made financial inclusion a priority within the agency and the credit union system as a whole. I recently reinforced that commitment with the launch of a new financial inclusion initiative called ACCESS (Advancing Communities through Credit, Education, Stability, and Support). This initiative will refresh and modernize regulations, policies, and programs that all support greater financial inclusion within the agency and the credit union system and will address the specific needs of diverse communities. I look forward to working in partnership with the members of this committee towards this worthy endeavor.

In closing, I would like to thank the committee again for the opportunity to appear before you, and I look forward to answering your questions. Thank you.

[The prepared statement of Chairman Hood can be found on page 97 of the appendix.]

Chairwoman WATERS. Thank you, Chairman Hood.

Chair McWilliams, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE JELENA MCWILLIAMS, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)**

Ms. MCWILLIAMS. Thank you, Chairwoman Waters, Ranking Member McHenry, and members of the committee and staff, and thank you for the opportunity to testify today. I hope that you and your families are staying healthy.

When I appeared before you 6 months ago, we were confronting great uncertainty and volatility due to the COVID-19 pandemic. Many industries and segments of the economy were experiencing unprecedented declines in activity, and this shock was reverberating throughout the financial system. Although there remains considerable uncertainty about the path of the economy, the banking system has served as a source of strength throughout this period. Banks of all sizes have supported their customers and communities, including by originating nearly $500 billion in Paycheck Protection Program (PPP) loans and accommodating more than $2 trillion in new deposits over two quarters.

Today, I will provide an update on five areas in which the FDIC has made significant progress: responding to economic risks related to COVID-19; enhancing our resolution readiness; supporting communities in need; prompting diversity and inclusion at the FDIC; and fostering technology solutions and encouraging innovation. My written statement provides greater detail in each of these areas, but I would like to briefly touch on each of them, starting with how we responded to the economic risks related to the pandemic.

Beginning in early March, the FDIC and our fellow regulators undertook a series of actions that helped maintain stability in financial markets. In addition to providing flexibility for banks to work with their borrowers, we made many targeted, temporary regulatory changes to facilitate lending and other financial intermediation. We continue to monitor conditions and receive feedback from supervising institutions, and we will consider additional guidance as appropriate.

As the FDIC responded to the immediate impact of the pandemic, we also focused on enhancing our resolution readiness in several ways. Although we entered the pandemic with a historically low number of bank failures, we recognize that the absence of failure could not last forever. Accordingly, the FDIC approved our resolution-related capabilities by, among other actions, centralizing our supervision and resolution activities for the largest banks, establishing a new approach to bank closing activities to help protect the health of our employees during the pandemic, and carrying out targeted engagement and capabilities testing with select firms on an as-needed basis.

We are particularly mindful that minority and low- and moderate-income (LMI) communities have suffered disproportionately during this pandemic. Shaped by my personal experiences and guided by commitments to increasing financial inclusion in traditionally underserved communities, one of my priorities as FDIC Chairman has been expanding our engagement and collaboration in support of Minority Depository Institutions (MDIs).

One of the options we are exploring is a framework that would match MDIs and CDFIs with investors interested in the particular challenges and opportunities facing these institutions and their communities. We are in the process of creating a vehicle through which investors' funds will be channeled to make investments in or with MDIs and CDFIs. We are still developing the details but expect to release more information in the near future.

The FDIC is deeply committed to fostering a diverse workplace and an inclusive work environment. Although we are not yet satisfied with our progress or the pace of change, we have taken meaningful steps in furtherance of this goal and we will not stop.

The racial, ethnic, and gender diversity of the FDIC workforce continues to steadily increase. At the end of 2019, minorities represented over 30 percent of the permanent workforce, and women accounted for approximately 45 percent. The FDIC has also increased diversity across our leadership. Minorities hold 22 percent of the management level positions, and women hold 39 percent, up from almost 16 percent and 30 percent, respectively, 10 years ago. Likewise, my senior leadership team comprises a diverse set of individuals. Notwithstanding, we know more needs to be done, and we are fully committed to doing it.

As we consider additional ways to create a more inclusive banking system, we must recognize the tremendous benefits that financial innovation can deliver to consumers. Our recent biennial survey on household use of banking and financial services shows that individuals are increasingly moving to digital banking. To enable this evolution, we established an office of innovation, FDiTech, and began working on several initiatives. Notably, we recently sought feedback on a groundbreaking approach to facility technology partnerships within banks and fintechs which aims to reduce the cost and uncertainty associated with the introduction of new technology at an institution.

Thank you again for the opportunity to testify today, and I look forward to your questions.

[The prepared statement of Chair McWilliams can be found on page 112 of the appendix.]

Chairwoman WATERS. Thank you, Chair McWilliams.

Vice Chairman Quarles, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE RANDAL K. QUARLES, VICE CHAIRMAN OF SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (FED)**

Mr. QUARLES. Thank you.

Thank you, Chairwoman Waters, Ranking Member McHenry, and members of the committee, for the opportunity to testify today on the Federal Reserve supervisory activities.

My last appearance before this committee in May followed a period of historic financial stress. The emergence of COVID-19 and the measures taken in response added a deep strain of uncertainty to financial markets, which prompted a sharp and global flight from riskier, more volatile asset classes and a retreat to the safety of cash. That retreat demanded immediate, extraordinary, and concerted public intervention to ensure stability, restore calm, and see the nation through an unfolding crisis.

The Federal Reserve's intervention spanned a wide range of intermediaries and markets, including the banking sector. Strengthened by a decade of improvements in capital, liquidity, and risk management, including the refinement and recalibration of the last 3 years, banking organizations became an important shelter from financial distress. Our goal was to ensure that this shelter stood fast, that banks could respond to the emergency and address consumer, business, and community needs without jeopardizing their own safety and soundness.

The report accompanying my testimony lists these actions in detail, and we have extended several of them as the COVID event has continued. They include temporary adjustments to capital and reserve measures, compliance requirements. They include offsite examination activity. [inaudible] They clarify beyond doubt that safety and soundness are no impediment to working constructively with borrowers and other customers in times of strain.

Together with monetary, financial stability, and fiscal actions, these regulatory measures helped calm the waters. The initial wave of market stress has passed, and the recovery has begun much sooner than expected. This speaks to the country's tenacity, ingenuity, and spirit in responding to even the greatest of shocks.

The challenge we face now is distinct, formidable, and complex. The surprise of the COVID event is gone, replaced by a clearer view of its economic consequences. The burdens facing households and businesses are better understood, but they are no less significant, and they are not evenly borne. I am confident that we will work through them together, support those hardest hit, and ensure that our economic wounds do not become scars.

The Federal Reserve remains committed to using our full range of tools to support the economy for as long as needed. A strong, resilient banking system is an essential element of such support. A durable recovery demands banks that lend actively, confront gains and losses honestly, withstand unexpected shocks, and help customers rebuild and adapt. Our task as supervisors is to ensure that the country's banks continue to meet that exacting standard.

The Federal Reserve's earliest COVID-related guidance encouraging banks to work constructively with the borrowers was an important step toward this goal. Since then, working with our colleagues in other financial regulatory agencies, from principles to guide COVID-related credit accommodation through a clearer statement on Community Reinvestment Act consideration of COVID-related activities, to steps that make it easier for banks to participate in emergency lending programs. It also includes the use of flexibility in our stress testing apparatus to better understand the effects of the COVID event shock on the strength of banking organizations.

As our report shows, that strength is still intact. Liquidity and capital remain high and, indeed, have increased at our largest banks over the course of the COVID event. Firms have sharply increased their reserves, setting aside resources today against possible losses tomorrow. Banks are well-positioned to serve as a bulwark against broader financial and economic stress.

It is worth recognizing how things might have been different. This foundation would not exist after a once-in-a-century shock, if not for a decade of work by officials and the banks themselves to make banks stronger and more stable and to make banking supervision fairer, more efficient, and more transparent. Those values are not contingent only for an economic boom. They represent an ethic and a commitment to addressing the most pressing supervisory and regulatory issues in the most effective ways that are even more critical during a crisis. That ethic has steered the Federal Reserve through the last 7 months and will continue to guide us through the recovery.

COVID-19 changed many aspects of the Federal Reserve's work. It also affirmed the values and priorities that remain the same, those that will continue to guide us in our support for the financial system, the economy, and the country long after the COVID event has passed.

Thank you for your time, and I look forward to answering your questions.

[The prepared statement of Vice Chairman Quarles can be found on page 130 of the appendix.]

Chairwoman WATERS. Thank you, Vice Chairman Quarles.

Acting Comptroller Brooks, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF BRIAN P. BROOKS, ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)**

Mr. BROOKS. Chairwoman Waters, Ranking Member McHenry, and members of the committee and staff, thank you so much for the opportunity to update you today on the OCC's work ensuring that the Federal banks operate in a safe, sound, and fair manner and remain sources of strength for their communities.

Over the past 8 months, the OCC has supported the orderly function of our banking system through an extraordinary time. Fortunately, banks and savings associations entered this period with near historic high levels of capital and liquidity. Asset quality was strong, and the economy had enjoyed the longest expansion on record. And then, as part of the national response to COVID-19, economic activity was suspended. Regulators at this table collaborated to provide banks the flexibility necessary for them to use that strength to support their customers and to sustain economic activity. My testimony today will provide detail on the actions the agency has taken on this front.

Now, today, we continue to monitor the effects of shutting down the economy. While banks remain sound, we see potential for troubled assets ahead in commercial and residential real estate, small business and consumer lending, and travel and hospitality sectors. Banks, particularly those with concentrations in those assets, must take a sober view of their risks and work with customers to the maximum extent possible consistent with safety and soundness.

The recent OCC semiannual risk perspective highlights the credit, operational, and compliance risks in the system, which we will focus our supervisory efforts on in the months ahead. Prudent risk management today can avoid the need for more extreme loss mitigation tomorrow. Having said that, we also see reasons for cautious optimism about the future based on strong third quarter GDP growth, continuing reduction in unemployment, strong consumer and small business sentiment, and better-than-expected news about the near-term availability of effective COVID-19 vaccines.

While the economy and banks clearly face uncertainty as to the length and depth of the pandemic's trough, I also want to highlight what gives me optimism for the future of banking and, frankly, for the future of the country.

During the social unrest that followed the killing of George Floyd this summer, it became clear that the protesters were angry, among other reasons, because too many Americans have been left out of our national wealth creation engine for far too long. The OCC founded Project REACh for just this purpose, to convene bankers, civil rights leaders, innovators, and business people to promote full, fair, and equal participation in our economy.

The Project is working to eliminate obstacles to credit for 45 million people with no usable credit score, to expand affordable housing for those who cannot afford high down-payment requirements, and to reinvigorate minority banks that serve often neglected communities. And we have now kicked off regional REACh efforts, including one serving the greater Los Angeles areas, Chairwoman Waters, that you and I both call home. And we have hosted events on access to capital and credit in places ranging from South Carolina to Colorado.

I have been humbled by the momentum among the industry, community and civil rights advocates, and our staff. Indeed, Project REACh has become a movement to tear down barriers so that all may pursue their American Dream.

Another reason for my optimism comes from innovators within banks and elsewhere who are excited about improving banking and financial services to consumers, businesses, and communities. We are seeing new products and better ways of delivering them and much more efficient ways of operating. Ultimately, this progress will benefit consumers and businesses as people have greater choice and more autonomy over their financial well-being.

At the OCC, we believe that consumers, businesses, and the economy are best served when this innovation can occur within the banking system and the system is allowed to evolve as consumer preferences evolve. Now, we think this for several reasons. First, the banking system is among our most strictly regulated and most closely supervised industries. Those who fear that innovation may harm consumers should consider the possibility that innovation might be safer in a supervised environment than it is under the current, largely unsupervised one.

The same is true for those focused on prudential risk. Over the last decade, it is clear that large market shares of lending and payments have migrated from the commercial banks into less-regulated shadow banks. This trend reduces our collective ability to spot and manage issues early on. And, of course, we should not underestimate the risk of a status quo in which incumbents seek protection from competition and, thus, delay the delivery of innovative financial services that are already available in other parts of the world.

The OCC has been a leader in this area since coining the phrase, "responsible innovation," in 2015. We remain committed to encouraging responsible efforts to deliver more choice and more economic opportunities in safe, sound, and fair ways within the Federal banking system to benefit consumers and businesses across the country.

Thank you again for this opportunity. I am very proud to have served as Acting Comptroller of the Currency and to support the agency's important mission. I look forward to your questions.

[The prepared statement of Acting Comptroller Brooks can be found on page 66 of the appendix.]

Chairwoman WATERS. Thank you very much.

I will now recognize myself for 5 minutes for questions.

First, let me just ask each of you about the deregulatory efforts that you have made during this pandemic, despite the fact that this committee specifically asked you not to do that. I won't go into all of the deregulations, but simply, I would like to ask each of you, would you commit to freezing these deregulatory actions? Let's go right down the row on this and ask each of you if you would agree to freeze the deregulatory actions that you have taken. We will start with Mr. Brooks.

Mr. BROOKS. Chairwoman Waters, thank you for the question. I guess I don't perceive what we have done at the OCC as particularly deregulatory. We have regulated a true lender in ways that solve the rent-a-charter problem by holding banks accountable for their marketplace lending partnerships. We have provided lists of community reinvestment activities to make clear which things will count. We have fined banks record numbers of dollars and fined individual bank executives in ways that have never been done before to hold them accountable.

Chairwoman WATERS. Okay. Reclaiming my time here, you are saying that no, you don't feel that you have done anything that is deregulatory. I hear that.

Chair McWilliams, what about you?

Ms. MCWILLIAMS. Chairwoman, I am afraid that you don't want us to stop, because some of the things that we have done actually have ensured that borrowers and consumers, especially low- and moderate-income people, can stay in their homes. We have done a number of things to either satisfy the role of Congress that you implemented through the CARES Act or to ensure that our regulated entities have an opportunity to work with their borrowers proactively and not have a repeat of the 2008 financial crisis.

Chairwoman WATERS. Okay. So, you are saying no, also. You don't feel that what you have done is deregulatory.

Vice Chair Quarles?

Mr. QUARLES. Yes. The changes that we have made have been designed to ensure that the right incentives are in place to ensure we have a resilient financial system. And I think as we consider the resiliency of the financial system, we should be willing to do what is necessary to keep it safe and sound.

Chairwoman WATERS. Thank you.

Chair Hood?

Mr. HOOD. Yes, ma'am. All of our efforts have been to provide regulatory relief and flexibility so credit unions can serve their members during the time of the pandemic. Every action I have taken to date is to do things such as providing the loan forbearance. In fact, credit unions have now made over 1.7 million loan forbearance loans to the amount of $55 billion.

Chairwoman WATERS. Okay. Thank you. If I may interrupt, you don't feel that you have done anything that is deregulatory, is that right?

Mr. HOOD. Only to aid the credit union member owners.

Chairwoman WATERS. Thank you very much.

I want to just go now to Chair McWilliams. We talk a lot about diversity and inclusion, and I am very interested in what is happening with our small banks, some of the community banks. Is it true that we have banks that are basically closing down, they are leaving banking, or is that just a rumor?

Ms. MCWILLIAMS. Chairwoman, when you say banks closing down and—

Chairwoman WATERS. Community banks.

Ms. MCWILLIAMS. Community banks. There has been a great consolidation trend for years now. And as you are probably aware, we lose about 200 to 220 community banks to mergers every year. So, yes, banks or community banking—

Chairwoman WATERS. Of any of those banks that you described as having merged, have you had the opportunity to interact with Blacks or Latinx about bank ownership and acquisition of banks that are being merged?

Ms. MCWILLIAMS. Yes, we have. And, actually, one of the key components of our MDI outreach efforts, in pursuit of our mandates to preserve and promote them, has been to look at the ways that would provide that an entity that is being sold, that is either failing or about to be sold—

Chairwoman WATERS. Have you been involved in any acquisitions by MDIs or Latinx bankers?

Ms. MCWILLIAMS. We are in constant discussions with our MDI banks—

Chairwoman WATERS. Have you been successful at any? Do you know of any acquisitions that have been made by MDIs or Latinx bankers?

Ms. MCWILLIAMS. Yes.

Chairwoman WATERS. Would you tell me which ones they are, please? We don't know of any, and I am really interested in this.

Ms. MCWILLIAMS. I would be happy to provide you that information. I don't have the information in front of me, but I am in active discussions with a number of MDI banks to make sure that they have an opportunity to acquire failing MDI banks.

Chairwoman WATERS. That is my question, and if you have been successful, I want to know about it, because we are talking about wealth building and we are talking about opening up opportunities that have not been available in the financial system. And so, I want to know more about this and whether or not you actually have a program by which you will be outreaching to ensure that these opportunities are opening up to MDIs. So, I want to thank you very much.

And I now recognize the ranking member of the committee, Mr. McHenry, for 5 minutes.

Mr. MCHENRY. Thank you, Madam Chairwoman.

And what I would like to first say to this group of regulators is that this committee has followed very closely your actions since this unprecedented pandemic has hit this country and the world. And I have great confidence that the actions that you have taken have made a very challenging situation, a very challenging health situation that has become a challenging economic situation, that because of your actions, we have been able to prevent a financial crisis. And without your concerted action, until the final moment that you are in your seats, the American people would be in a tougher position than they are currently in.

So what I want to ask you to do and to commit to do is, to the fullness of your terms of office, that you do the business that you have set out to do to ensure the safety and soundness of institutions, that the American people can have confidence that their regulators are on the job, watching out for them, and taking every action necessary to prevent bad outcomes. And so I commend you for that action, but I also urge you to continue this good work.

To that end, the work of the Federal Reserve has been foremost in this discussion. And so, Chair Quarles, I want to commend you for the actions of the Federal Reserve since March especially, but we also need to know this process going forward. And so, as I have mentioned before and raised with you before, we want a clear understanding of the path forward on the London Interbank Offered Rate (LIBOR). This is an important rate for a number of financial products, looking at over $200 trillion notional value for contracts, and we know that LIBOR is ending at the end of 2021. So can you give us some assurance about your process going forward?

Mr. QUARLES. Yes, I would be happy to do that. The issue that you raised, I think, is an important one from a stability point of view, which is that there are a lot of legacy contracts that current rely on LIBOR, but that we need to define a path forward for them after the end of 2021. The transition for new contracts is going pretty smoothly. The legacy contract is the big issue there.

I think finding a way to allow those legacy contracts to continue for at least some period, to allow the bulk of those legacy contracts to mature on their existing terms without a significant change, would probably be the best way forward, and we are working on a method to do that. There are a variety of different ways one could do that, but I would expect over the next couple of months to be able to publicly define the way forward to address that.

Mr. MCHENRY. Thank you, Vice Chair Quarles. And at this point, do you have a legislative request or a need for legislative action by the Congress?

Mr. QUARLES. I think that the ultimate transition will ultimately require some legislative element, but at this point, I think the answer would be no, because I think it's good to—I think what we want to try to do is find a way to allow those contracts to mature before we have a legislative solution for the so-called hard tail.

Mr. MCHENRY. Yes. Thank you.

Chair McWilliams, I want to commend you for the action you have taken to modernize the FDIC, to focus on financial innovation and to use technology to keep your people safe and secure, and also, our institutions safe and secure.

Mr. Brooks, I want to commend you for the actions you have taken on OCC's true lender rulemaking to provide certainty and clarity on those partnerships that are very important for our current economy. Can you, Mr. Brooks, at the top line describe how that rule will work in practice and why it is a good thing?

Mr. BROOKS. Ranking Member McHenry, thanks for the question. Two quick top lines. First of all, the purpose of the rule is to redress what happened in light of the Madden rule, which reduced the availability of credit to low- and moderate-income Americans by as much as 64 percent. And so, allowing banks to leverage their balance sheets will solve that. We have also addressed the rent-a-charter problem by making clear that banks that do those partnerships are accountable for all consumer compliance obligations.

Mr. MCHENRY. Thank you. Thanks for your testimony. Thank you all for being here or being wherever you are. Thanks so much.

Chairwoman WATERS. Thank you very much.

Mrs. Maloney of New York, you are now recognized for 5 minutes.

Mrs. MALONEY. Thank you, Madam Chairwoman, and congratulations on your reelection, and to all of my colleagues, it is great to be back in business.

My question is for FDIC Chairwoman McWilliams. The COVID crisis is a threat to our economy. It will not go away until we have a vaccine, sto we should be using every tool at our disposal to guarantee the safety of our banking system. During the Great Depression, over 400 banks failed, and one of the most important lessons we learned from that time was the need for banks to shore up sufficient capital to withstand severe economic downturns.

And, Chairwoman Williams, my question for you is, given the positive correlation between economic downturns and bank failures, are you expecting an increase in bank failures at this time?

Ms. MCWILLIAMS. Thank you for that question. The bottom line is that fortunately, and fortunately for me at this time, we entered the pandemic and the related financial crisis caused by the government shutdowns with banks very well-capitalized, with high liquidity levels, and the lowest number of banks on the problem bank list. Thus far this year, we have had four banks fail. Historically, when we look at our data, during good times, we have about five banks fail a year. So I would say we are on trend for just a normal year thus far, which surely shows the resiliency of the financial system as highlighted by Vice Chairman Quarles in his opening statement.

We are grateful for the efforts of the banks to shore up their capital balances and liquidity during the good times, and we are certainly monitoring conditions on the ground to make sure that they can do what they need to do. But I also want to highlight that I am not sure that we would be in as good of a place as we are right now if we did not take a number of regulatory actions over the past few months to make sure that banks can stay in the business of banking and that, for example, loans that were modified for the purposes of the pandemic, that were performing before the pandemic, would not constitute troubled debt restructuring.

And if I can just highlight briefly, during the 2008 crisis, the reason banks were not really eager to modify loans up front is because they weren't sure how the regulators were going to treat those loans, and they didn't want to have nonperforming loans and impaired debt on their books. So, it was imperative for us to act quickly and promptly to make sure that we have good banks that are serving their communities, that consumers can stay in their homes and that, frankly, the FDIC doesn't have to jump into action with more bank closures than absolutely necessary.

Mrs. MALONEY. Some countries have prohibited dividend payments to shield their banks. Do you believe that prohibiting dividend payments would help our banks shield them from failure, forcing them to hold onto more of their capital?

Ms. MCWILLIAMS. Sure. That's a great question. And I will tell you, with respect to small banks, community banks, a lot of those banks are privately held. Their investors are friends and family. They are local farmers, schoolteachers, et cetera, who sit on the boards of those banks and actually have ownership in the banking system. So having a blunt cut instrument such as just across the board dividend, I would say, would probably hurt those communities and the investors in community banks.

We have supervisory tools where we can manage dividend payouts if we are concerned about the bank's capital position, and we have certainly utilized those tools in the past as appropriate.

Mrs. MALONEY. I have a question for Vice Chair Quarles, if I have the time. Your latest stress test found that several banks could be at risk of reaching minimum capital levels. As a result, the Fed banned stock buybacks, but only limited dividend payments by the largest banks to safeguard their solvency. So given the continued uncertainty of, really, the crisis with COVID, do you think that the Fed should have prohibited dividend payments entirely?

Mr. QUARLES. During this period, given the capital conservation measures that we put in place, the capital positions of the largest banks have actually increased even while they have been taking record levels of provisions. And we are running stress tests currently in light of the events of the spring and the effects of that on bank balance sheets in order to determine at the granular bank level what we think the effects of potential [inaudible] losses might be. So, I think we have been in a pretty good position. I think, though, that events have demonstrated that the measures we have taken have been effective.

Mrs. MALONEY. I believe my time has expired, and I yield back. Thank you.

Chairwoman WATERS. Thank you very much.

I now recognize Mr. Lucas for 5 minutes.

If Mr. Lucas is not available, I will go to Mr. Posey for 5 minutes.

Mr. POSEY. Thank you very much, Madam Chairwoman.

During times of stress for our financial institutions and markets, we have the obligation to temper safety and soundness so that our potential fears over an event like this pandemic will not goad us into adopting such stringent prudential standards that we exacerbate the stress. I have the same concerns related to the troubled debt restructuring and associated accounting standards during our recovery from the financial crisis.

Madam Chairwoman, you and I co-sponsored a bill to address these concerns during the recovery from the financial crisis. As you know, the bill placed common-sense parameters around putting loan modifications, often called troubled debt restructuring, or TRD, into nonaccrual status. That status negatively impacts capital requirements and it pushes banks away from working with customers facing difficulties and more toward extreme solutions such as foreclosure.

I was so pleased that this committee worked together in a bipartisan manner to mitigate the impacts of accounting practices on troubled debt restructuring in the CARES Act. We need to extend that relief for a while longer, though I have concerns about tying that extension to sweeping expansion of consumer forbearance for a wide variety of credit such as credit cards and installment loans.

As we know, forbearance for one entity in the chain of financial transaction creates yet another potential liquidity crisis for subsequent people. And we have other bills here today, like a treatment of PPP loans, that I believe have merit.

For Mr. Quarles, as I mentioned, there is legislation before the committee to extend the pandemic-related relaxation of accounting standards associated with the troubled debt restructuring. This provision was included in the CARES Act. The language allowed banks and credit unions to provide relief to consumers and businesses by temporarily removing the burdensome troubled debt restructuring classification requirement. Financial institutions that will actually take advantage of this provision will be required to provide forbearance to consumers for a wide variety of loans, including installment debt and credit cards. Small businesses will also be afforded forbearance for a wide array of loans.

The bill would impose conditions of how the loan balances deferred in forbearance could be repaid. I am interested in your candid evaluation. What would be the first concerns about such forbearance, if any?

Mr. QUARLES. Thank you. Thanks for that question. I think the current forbearance provisions, as you know, obviously, will allow any changes that the adjustments were made before the end of this year be for whatever length that the bank and borrower would agree, so the forbearance doesn't really end at the end of this year. It is the ability to make new changes that ends at the end of this year.

I do think that in general, it is good for us to move as promptly as possible to regular order where the challenges that are facing banks, given the position of their borrowers, are at least recognized. So at least what we are seeing right now is not a—as banks begin to understand the fact that the forbearance that is available under the law doesn't end at the end of the year, but simply that they must make their decisions by the end of the year. We aren't getting a lot of pressure, at least at the Federal Reserve, for that extension, but ultimately, that would be a decision for Congress.

Mr. POSEY. Thank you.

Madam Chairwoman, I have a couple more questions, but by the time I ask the questions, there is not going to be time to answer them, so I will yield back the balance of my time.

Chairwoman WATERS. Ms. Velazquez, you are recognized for 5 minutes.

If Ms. Velazquez is not available, we will go on to Mr. Luetkemeyer for 5 minutes.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. I would be willing to yield to Mr. Lucas, who is above me in ranking here, because I think he missed his mute button a while ago. If he has found his mute button, he can take the spot, and I will follow up in a moment.

Chairwoman WATERS. Thank you.

Mr. Lucas, you are recognized for 5 minutes.

Mr. Lucas?

Mr. LUETKEMEYER. Apparently, he hasn't found the mute button yet, but—

Chairwoman WATERS. We will let him continue to look as we go on, Mr. Luetkemeyer.

Mr. LUETKEMEYER. Okay. Thank you very much. Thank you, Madam Chairwoman.

Before I begin my questioning, I would like to applaud all of you, the regulators this morning, for proposing to codify the 2018 interagency statement on guidance and place a binding rule on the agencies that supervisory guidance does not have the force and effect of law. This has been something that I have consistently worked on in Congress, and I look forward to continuing to work with you all to draw a clear line between rule and guidance and what is enforceable and what is not. So I appreciate your attention to that and I look forward to continuing to work with you.

To follow up on Mr. Posey's conversation with regards to troubled debt restructuring, I have a bill out there to do this as well. And I am very concerned that at the end of the year when we run out of—when the CARES Act sunsets, the TDR provision that is in there, that regulators will have minimal options to—nothing to point to legislatively or any sort of other law to say that they can take a different approach on this. I can tell you from discussing this with the banking industry folks and the credit union folks, that they are very concerned about having to rely on guidance, having to rely on something like that to make these decisions in order to give forbearance to their customers, whether it be for home loans, car loans, or their business loans.

Chair McWilliams, you and I have talked about this at length, but just to get you on record here with what we are talking about, where are you and what are your plans with regards to TDR guidance and how you want to work with your set of regulators and the people they regulate, which are the banks, and hopefully their customers will be impacted by those decisions?

Ms. MCWILLIAMS. Thank you. Thank you for that question. As you know from our discussions back in March, I was really concerned about loans not being modified and banks being concerned about having impaired debt and driven by the examples from 2008 where some of these loans, once modified, were treated as impaired debt or troubled debt restructuring. They are still performing now 10 years later, 20 years later, but they are still on the books as troubled debt, which doesn't bode well for the bank.

So driven by that, we have worked with—amongst these regulatory bodies here at the table, I would say, but on the screen—we have worked with the financial accounting standards boards to make sure that our banks can modify loans that were performing prior to the pandemic and not have TDRs on the books. And then subsequently, Congress enacted similar provisions in the CARES Act.

So I would say that is probably one of the main reasons that you have seen homeowners stay in their homes and small businesses have access to credit during very, very tumultuous months in March and April. And we are certainly open to considering what additional actions Congress may come up with to make sure that we can enable banks to work with their borrowers.

Mr. LUETKEMEYER. Thank you for that. I can assure you that the institutions desperately need to have certainty on this on forbearance, because if they are not able to get it from the regulators, it is going to be very difficult for them to give it to their customers. So, we thank you for that.

Chairman Hood, you had an article, I think last week in your Credit Union Times magazine, with regards to Current Expected Credit Losses (CECL). And I appreciate that position you took, again, indicating that CECL is going to be detrimental to the credit union folks. It needs to be done away with. It is going to be procyclical.

And I know, Mr. Quarles, you and I have talked about this as well, quite a bit. And we are three quarters into the year here now with CECL data. I know the bigger banks, at the very beginning of the year, actually had to roll over another 30 to 35 percent into the reserves, and while that is fine, eventually that stresses out the income. So would you like to comment on it just a little bit, please?

Mr. HOOD. As you know, we have immediately, as a result of the COVID event, extended the transition periods for smaller banks. They will be insulated from the capital effects of CECL for 2 years, and then a 3-year phasing will begin. I do think that gives us the ability to understand what has happened and what the implications of CECL are, particularly as we see it operating with the larger banks, and we can then make any permanent adjustments that we think are necessary.

Mr. LUETKEMEYER. I see my time is up. Thank you very much. I appreciate Chairman Hood's position on it as well. I yield back.

Chairwoman WATERS. I now recognize Mr. Sherman for 5 minutes.

Mr. SHERMAN. Thank you. I have a couple of comments. Ranking Member Luetkemeyer said in his statement that our economy grew 33 percent. The more accurate way to say that is that we grew 8 percent during the third quarter. I don't know if you can extrapolate that. And, of course, that was only a halfway bounceback from a terrible second quarter.

This crisis continues. During this crisis, it makes sense to have limits on the stock buybacks and the dividends paid by large banks. That is why I wrote you, Mr. Quarles, back in early March, urging that you prohibit dividends and stock repurchases by megabanks during this crisis.

You have, in fact, taken some action, and particularly on stock buybacks, and I hope that we can count on you to continue to limit stock buybacks and dividends as well until this crisis is over so that we are not confronted with the need to or the—at least the asserted need to bail out huge financial institutions.

We have talked about the troubled debt restructuring relief, which allows banks to restructure their debt to aid consumers and small businesses without being penalized. This CARES Act provision expires at the end of this year, though we have heard testimony that it could be applied next year to forbearance agreed to this year, that there may be forbearance agreed to next year.

So I would ask, Mr. Brooks, do you have the authority to extend this loan modification flexibility for loan modifications made during the 2021 part of this COVID crisis, and if you do, do you plan to exercise that authority?

Mr. BROOKS. Congressman Sherman, thank you for that question. These are really important issues. And what I would tell you is, there are certain aspects of this where without an extension of the CARES Act, we would have statutory inability to do certain things, and that is because we are statutorily required to hold banks accountable for gap financial reporting.

On the other hand, we have significant flexibility to protect banks from the impact of TDR treatment under various categories, and I think we have communicated some of these to your colleagues in writing. These include things, for example, like determining what TDR impact is immaterial, which is then excluded from the gap TDR standards. It also includes things like making determinations about when banks would be required to refile a call report or not, and so, there are a number of things we can do to mitigate effects.

Mr. SHERMAN. I hope very much that we will pass additional legislation. I know that even before we passed legislation, you had a regulation project, which means you had the authority before we acted. Hopefully you will have that authority after our actions are no longer effective, unless, of course, we are able to extend them, which, I hope, the wisdom will perhaps arise in the United States Senate. Anything is possible.

As to LIBOR, we have $2 trillion of legacy LIBOR. Most of those instruments do not provide a replacement rate to be used in calculating the amount of interest payable once LIBOR is no longer published at the end of next year. Some of those instruments provide that the lender gets to pick the rate, which would be an outrage if you are the borrower, and all of a sudden some new rate is imposed on you, and that is why the National Consumer Law Center, the Student Borrower Protection Group, et cetera, are very concerned about this as is, I think, the financial services community.

I know there is some discussion as to whether legislation is necessary. I clearly think it is, in that I don't know how, if the instrument does not indicate how interest is to be calculated, anything other than legislation could solve that problem. I have put forward a discussion draft, and it reflects the suggestions of the Alternative Reference Rates Committee.

What would be the consequence, Mr. Quarles, of simply not having any regulatory or legislative solution? Would this result in an awful lot of class-action lawsuits, et cetera?

Mr. QUARLES. If there were no solution at all, yes, when we—when LIBOR stops, there would be significant disruption. I think that there is a way, as I indicated in my answer to Mr. McHenry, that we can combine current measures that allow the bulk of the existing contracts to mature on their existing terms and then save legislation for the hard tail, when we have had more time to think about it. That may work best.

Chairwoman WATERS. The gentleman's time has expired.

Mr. SHERMAN. I think we need to act on it. I yield back.

Chairwoman WATERS. Thank you. I will now recognize Mr. Meeks for 5 minutes.

Mr. MEEKS. Thank you, Madam Chairwoman. First, I want to thank you, Madam Chairwoman, as well as Ranking Member McHenry, for your active engagement on the bills that I drafted, which I believe were some of the most impactful bills that supported MDIs and CDFIs in a generation.

Similarly, I want to thank, with an expressed gratitude, each of the regulatory agencies present here today who offered constructive input into these bills. We haven't always agreed, and, in fact, we have had some deep, deep, deep disagreements. But I believe with conviction that these bills matter, and that the collaborative approach is critical as we seek to redress structural discrimination and systemic inequalities that hold back too many families across our country. MDIs and CDFIs are essential pillars to tackling the systemic problems that we seek to solve.

Chairwoman McWilliams, would you agree that MDIs and CDFIs are key pillars to addressing the issues of inequality and discrimination in our banking system? And also, I guess, would you thereby commit that the FDIC would work actively to implement the provisions of this legislation if signed into law?

Ms. MCWILLIAMS. Thank you for that question. I will say that community banks serve their communities. That is why they are called community banks. But, in particular, minority depository institutions are at the very forefront of serving their communities, and those communities happen to be low- and moderate-income people and people of color. So I would say that they are not just pillars in their community, but in many cases, they are the only vehicle to get financial services for the communities that have traditionally been underserved and underrepresented in the banking system.

So we are working very hard to make sure that those banks can sustain themselves, that we do what we can at the FDIC to make sure that they have regulatory flexibility. And the creation of the fund that I briefly discussed in the opening statement would hopefully help MDIs and CDFIs get additional capital. They really need capital.

And so, we thought about, we can do a number of things on the regulatory side, but they seem to be getting deposits from known MDIs, they seem to be getting some assistance on the technical side, but they really need capital. So the idea behind this fund is to provide resources and have others invest into MDIs and CDFIs so that they can continue to serve their communities.

Mr. MEEKS. I couldn't agree with you more. And I think that your initiatives, which are supporting aspiring minority investors in MDIs so that they can strengthen their capacity, but it is also the case to strengthen the capacity of MDIs to acquire branches or operations of failing institutions.

Now, I think this is key, because without de novo banks, we are on a path to the disappearance of minority banks, which is what I am afraid of, because I fear that minority banks and MDI investors are being steered solely to the most challenging markets or failing institutions.

Can you elaborate a little bit more on how we can expand the number of de novo minority banks and support them in expanding and achieving scale? Because we see the numbers dwindling, and even as they merge, they dwindle more so that there will be less communities or less banks that are available throughout the United States of America. So what can we do to expand, so that more MDIs are created?

Ms. MCWILLIAMS. That is a great question. And really, your question has two components. One is, what can we do to make sure that the failing banks, or the branches that are being sold off MDI banks go to MDIs, so that those communities continue to be served by MDIs?

And I ran a little bit out of time when Chairwoman Waters asked the question, but we have changed the way that MDIs can bid and give technical assistance on failing MDIs so that they have additional time, they have 2 extra weeks, when we open up the books of the failing bank only to MDIs, while known MDIs have to wait for their time, 2 weeks later.

But we want to give them that advantage, that window of time for them to analyze and prepare bids for the failing MDI, which, frankly, is going to result in more MDIs that are failing or selling partially. Their businesses are offered an opportunity to go to other MDIs.

On the de novo front, I couldn't agree more with you. We need more new banks, and, frankly, some of these communities, rural communities in particular, and MDIs, there just aren't enough of them.

And, so, we have done a number of things at the FDIC to ensure that we have changed the way that we process and approve de novo applications for deposit insurance, so that there is an increased ability in the agility of investors and the organizers to have new banks. I would be happy to give you more information in detail, as I understand our time here may be up, but thank you for that question.

Mr. MEEKS. Thank you. I look forward to following up with you.

Ms. MCWILLIAMS. Thank you.

Chairwoman WATERS. Mr. Lucas is recognized for 5 minutes.

Mr. LUCAS. Let's try one more time, Madam Chairwoman. Can you hear my voice?

Chairwoman WATERS. Okay. Mr. Lucas, are you available for your 5 minutes?

Mr. LUCAS. Yes, ma'am. If you can hear me, I am available.

Chairwoman WATERS. Okay. You are recognized.

Mr. LUCAS. Thank you, Madam Chairwoman.

PPP is a very important program in my district, and I think it is very important to the survival of all businesses across this great country. And throughout the course of the pandemic, the banking system has served as a source of strength and a lifeline for struggling businesses across the country. And those banks have played a critical role in supporting small businesses through that Paycheck Protection Program distributing more than $0.5 billion.

As a result, many banks are at risk of crossing asset-based regulatory thresholds. What discretionary authorities do the Federal Reserve, the FDIC, and the OCC have to ensure that banks do not face additional regulatory burdens as a result of doing the important thing of participating in PPP?

I first turn to you, Vice Chairman Quarles, and then Chairman McWilliams, and then Comptroller Brooks, please, for your observations.

Mr. QUARLES. Thank you, and thanks for that question. Yes, we have been looking at that issue. I think you are exactly right. The various thresholds for the imposition of various regulatory measures exist for what are intended to be sort of durable and permanent changes in the status of a bank and temporary expansion of their positions, particularly in a time of stress and when they are supporting their customers. I think we need to look at how to address that. We do have the ability to provide temporary exemptions for most of these, and we are considering doing that.

Ms. MCWILLIAMS. And I would just add to that, to the extent that the FDIC has sole authority over some of these things, we have already acted, and we will continue to act. I would say that it shows that the financial system has served as a source of strength. The fact that over $1 trillion of new deposits have flocked to banks for each quarter since the beginning of the year in Q1 and Q2—we haven't gotten the data yet from Q3, and as soon as we have it completed, we will analyze it and provide it to the public.

But we are talking about over $2 trillion. And so what we have done at the FDIC is exempt from the deposit assessment any assets that have come to banks by virtue of their originations of the PPP loans through the Fed Facility. And we will continue to work with our fellow regulators to continue to do so.

Mr. LUCAS. Absolutely. Comptroller?

Mr. BROOKS. Congressman, thank you for that question. I guess, the other examples I would add on to what has already been said are, first of all, we made changes in the way that the supplemental leverage ratio was calculated, specifically to make it easier for banks to not have capital impacts of these kinds of things.

And in addition to that, there is ongoing interagency work across our three agencies to make sure that regulatory burdens that get tripped at different asset thresholds starting at $500 million, get a temporary exclusion of these kinds of assets so that banks below $10 billion don't find themselves in a harder regulatory climate. We haven't rolled those out yet, but we are hard at work on that at the staff level, and I expect we will roll that out before the end of the year.

Mr. LUCAS. Ever so briefly, Chairman Hood, can you speak to the effect of PPP loans on the credit union balance sheets?

Mr. BROOKS. Yes. All of the PPP loans receive a zero-percent risk rating in calculating the net worth. And I would also add that we, by statute, could only assess Share Insurance Fund premiums based on credit union insured shares and not assets, so therefore, they don't have an impact on the balance sheets as well. And in addition, credit unions originated over 171,000 PPP loans, so I am glad that we, as a board, were able to make those provisions.

Mr. LUCAS. Thank you, Chairman.

And I want to thank the chairwoman for her indulgence, and to thank Ranking Member Luetkemeyer for his efforts to help me as I worked through my technical issues.

I would offer one final thought, and that is, to all of my colleagues, be healthy, and be safe. While some of my children may think I was around for the 1930 election, on election night the Republicans had 218 seats, a majority. By the time Congress organized in March, through deaths and special elections, the Democrats had a 219-seat majority.

If a podcast of a nonpartisan news source was correct that I listened to this morning, and the difference will be three seats, we are in that kind of an environment, 1930 all over again. Just a thought to my friends in the Majority and the Minority.

I yield back, Madam Chairwoman.

Chairwoman WATERS. Thank you very much, and we will count on those three seats to be there when we need them.

Mr. Clay, you are now recognized for 5 minutes.

Mr. CLAY. Thank you, Madam Chairwoman. And let me say that 80 years ago was a little while, or 90 years ago was a little while for Mr. Lucas and me.

But my first question is for Vice Chair Quarles. With coronavirus cases surging this fall, our economy is still in a precarious position. Moody's projects that default rates for corporations could rise to as much as 15 percent next quarter. States and cities are facing estimated budget shortfalls of $1 trillion, and New York City recently saw its debt downgraded.

All of this creates the possibility that financial markets will be very volatile, and we may see a return to the disruption that we saw in the municipal bond market in March. With all of this in mind, do you believe it would be appropriate to eliminate the Municipal Liquidity Facility at the end of this year?

Mr. QUARLES. The data that you have provided are clearly correct, and I agree with that. We are not out of the woods on the [inaudible] of the economy. The economy has been coming back more quickly than we expected, but the unemployment rate is still high. There are still a lot of burdens on small businesses.

So we are looking very closely at what the acquisition ought to be with respect to all of the Facilities, including the Municipal Facility, at the end of this year. We haven't come to a decision yet. The situation continues to evolve, and we will make that decision towards the end of the year, but we are very mindful of the facts you have cited.

Mr. CLAY. What about the Main Street lending program? Is that in the same precarious position or—

Mr. QUARLES. All of the Facilities will expire at the end of this year, unless it is ended [inaudible]. I think it is true for all of them, certainly the [inaudible]. And so, we are looking at all of them, as to this question of whether they should be extended or not, and we are very mindful of the current environment.

Mr. CLAY. Are small businesses out of the woods yet, or do we still have some concerns?

Mr. QUARLES. No, I think there is certainly reason to be concerned about the pressures on small businesses. They have performed better—the stimulus that was provided in the spring, both from the Fed and from the Treasury, has been longer lasting than expected, but obviously, it is not going to last forever. I think that households are probably in better shape than small businesses, as you look at the economic performance currently. So, again, those are issues that we are looking at.

Mr. CLAY. Thanks for your response.

Mr. Hood, can you tell us what your agency is doing—and this is a follow-up to Mr. Sherman's question—to encourage your credit unions to do all that they can to help consumers and small business owners that need forbearance on their obligations?

Mr. HOOD. Credit unions have a long history, for almost a century, Representative Clay, of helping their member owners during times of adversity. We are encouraging our credit unions to do just that. I'm very proud of the fact that they have, to date, already been able to provide over 1.7 million forbearances, up to a total amount of $55 billion.

We continue to let them also know that in addition to our encouragement to help their member owners, that they will not have any of these actions held against them when our examiners come to do their examinations in the year ahead. That gives the credit unions great certainty in knowing that they will not be penalized for taking prudent and pragmatic approaches to helping their member owners survive this challenging environment.

Mr. CLAY. Thank you for that response.

Ms. McWilliams, is FDIC—are they doing anything to encourage your institutions to help small business owners and families with their forbearance obligations?

Ms. MCWILLIAMS. Absolutely. We have done a number of things to encourage our financial institutions to work with their borrowers, and we have instructed our examiners to show utmost flexibility when they are looking at the books of these banks for the next exam.

We have done a number of things to make sure that the PPP loans, as we discussed earlier, get processed for small businesses. We have issued a statement on the use of alternative data, which should help small businesses that usually have trouble getting traditional credit reporting metrics, et cetera. And I am happy to provide you additional information on what we have done.

Mr. CLAY. I see my time has expired, Madam Chairwoman, and I thank the witnesses for their responses.

Chairwoman WATERS. Thank you very much.

Mr. Barr, you are recognized for 5 minutes.

Mr. BARR. Thank you, Madam Chairwoman. It's good to see all of my colleagues, and I look forward to seeing all of you in person next week.

Chair McWilliams, according to a recent study by the FDIC, citizens in rural communities are much more likely than people in urban or suburban areas to visit bank branches for their financial needs. Unfortunately, those branches are becoming scarce in rural communities across the country. A recent Fed study found that a total of 794 rural counties lost a combined 1,553 bank branches over the last 8 years, a 14-percent decline. And I worry that this decline has only accelerated as a result of the pandemic.

And while more and more people nationwide are turning to online banking and mobile banking, this trend is slower among the rural population because of a diminishing number of not only bank branches, but also the lack of adequate broadband internet, which reduces their access to safe and reliable banking services. I have introduced bills to combat both of these issues, but the problems are exacerbated by the pandemic.

So, Chair McWilliams, given this data, how has the pandemic affected rural populations' access to banking services compared to their urban and suburban counterparts? And what can Congress do to ensure rural populations aren't cut off from the banking system?

Ms. MCWILLIAMS. It is an excellent question, Congressman, and, frankly, it is a question that we have struggled with for some time, recognizing that there is rural depopulation as more of the, I would say, younger folks are moving to urban areas where there are more jobs.

And I have done extensive outreach with our rural bankers to make sure I understand what is going on in those communities. Frankly, we don't have good metrics yet on the impact of the pandemic on the rural bank branches and banking services. We are hoping to do that postmortem, when we are past the dire straits.

But I would say that I have heard anecdotally that rural communities, in particular, have been hard-hit, not only by the pandemic itself, but that the economic shutdowns have affected them disproportionately, because there is a smaller number of businesses operating in those communities per capita. So when those businesses close, fewer people are able to get the benefit of being able to visit that business, and the ability of the workforce to get paid.

So I would say that anything that Congress can do to help rural communities in their time of need would be welcome, in the banking sector in particular. We will continue monitoring where we have branch closures. We will continue thinking about innovation and how technology and innovation can serve those communities, especially in areas where there is a single bank branch or no branch at all.

And we certainly think there is an opportunity for the Community Reinvestment Act to focus on these issues, as was done in the proposal that the FDIC joined the OCC on. And certainly, with broadband issues, we have highlighted that there should be CRA credit given for the broadband access expansion in rural communities so that banks know this, as well.

Mr. BARR. Yes, that is a great idea, Chair McWilliams.

And I noted Chairman Meeks' interest in the de novo charter issue. I want to work with him in a bipartisan way. Maybe we can combine my interest in rural banks and his interest in minority depository institutions, and do some good for all of these banking deserts.

Acting Comptroller Brooks, you and I have discussed this topic at length. I look forward to welcoming you to Kentucky next month to discuss access to capital in rural areas with community lenders and lenders in my district. How have the OCC's efforts, since the onset of the pandemic, including the updated CRA, attempted to mitigate the negative impacts of COVID on rural communities?

Mr. BROOKS. Congressman, thank you for the question. And as a two-time Kentucky Colonel, I am excited to come home to the Bluegrass State and do that event with you, so thank you for the invitation.

I would say there are two things that we can do together on this to make an impact quickly. The first is picking up on what Chairman McWilliams just noted, and that is, one of the main points of our CRA reform was to make lending and investment in rural communities a more attractive financial proposition for banks.

And so, what we did in the CRA reform that had never been done before, is we allowed banks to count loans made in small family-farming communities toward their CRA obligations, regardless of whether those areas were in their geographic assessment areas. So all of a sudden, we have used regulatory power to make those loans more economically attractive to banks that have ignored those communities for far too long.

And then the second thing, as you and I talked about, is it has simply taken too long to approve any kind of bank charter over the last 10 years, whether it is de novo in rural America, whether it is an MDI in an inner city somewhere or any other kind of bank.

And so, one of the things we have done inside the OCC in the last 6 months is to develop a new process designed to cut the timeline for getting bank charters in half from an average of about 18 months to an average of about 9 months. Once we can do that, I think you will find that organizers of banks in small-town Kentucky will have a much easier time seeing an end date for that and getting it across the line.

Mr. BARR. Thank you. My time has expired. I look forward to seeing you in Kentucky next month.

Mr. BROOKS. Thank you.

Mr. BARR. I yield back.

Chairwoman WATERS. Thank you.

I now recognize Mr. Green for 5 minutes.

Mr. GREEN. Thank you, Madam Chairwoman, and thank you also, Mr. Ranking Member.

I would like to visit with Mr. Brooks for just a moment. Mr. Brooks, you have your Project REACh, and within Project REACh, you have an alternative credit-scoring initiative. With reference to this initiative, I have some information indicating that you have said that you find promise in factors such as, do other people in your ecosystem or family have homes. I am curious as to how this will aid a person in paying bills. Could you kindly give me a response?

Mr. BROOKS. Sure. Congressman, there is nothing in Project REACh remotely about that. I have been asked questions in media events about the way that artificial intelligence in the future could be used to assess people's creditworthiness, and I have speculated that there are unknown factors, social factors and others that might be predictive.

Project REACh has nothing to do with that. What we are looking at in Project REACh is the inclusion of rent payments, utility payments, and bank cash flow data as a way of including people in the credit system and, especially in the wealth-building system where they have been excluded for years.

And I would just comment that of the 45 million Americans who don't have a credit score, Blacks are about 10 times as likely as Whites relative to their proportion of the population to not have a credit score. So we think finding a way to predict creditworthiness, particularly for African Americans, is one of the most important things we are doing at the OCC today.

Mr. GREEN. Thank you very much. I am pleased to have you clarify, and sometimes people do make mistakes in reporting on this. I have, on many occasions, had this happen to me.

I am also very pleased to hear you mention rental payments. Would you also include light bills, gas bills, phone bills? All of these things, if they are paid timely, would be indicative of a person's ability to not only be responsible, but also to meet obligations. Your thoughts?

Mr. BROOKS. Absolutely. This is an issue I have been working on for 25 years in my career, and it is a travesty that it has taken us this long to realize that a person's payment of a recurring obligation is predictive of their likelihood of paying a mortgage. So we need to fix this, and I think it is easier than people thought. I think we are going to be able to fix this quicker than people would believe.

Mr. GREEN. My hope is that you will get it repaired as quickly as possible, since you seem to have a good sense of what it is all about, and I appreciate it greatly.

I have some legislation, H.R. 123. It is styled the, "Alternative Data for Additional Credit FHA Pilot Program Reauthorization Act." And I would like to commend it to you. I would like to get this to you for your perusal, because I am interested in your input. Would you allow me to do so, and I will see if I can get the appropriate person on your team to get this to you?

Mr. BROOKS. Congressman, I wish you would, and I would love to talk to you about that personally when you have an opportunity.

Mr. GREEN. I promise you, we will have that conversation and it means a lot to me.

Now, let me go on to the MDIs, the minority depository institutions, if I may. I make it my business to try to understand what is happening with them, and a lot of what is happening with them is the lack of capital. It is true. But also, they have very small staffs, and when the OCC comes in to do what you normally do in terms of testing, it takes up a lot of the time that they have.

I am really interested in finding out how we can streamline this process so that it doesn't take up all of the time of the few people that they have who are having a hands-on experience with making the loans, so that they can stay in business while you are there doing what you do as a regulator?

Mr. BROOKS. This is a real conundrum, and I think there are two or three different prongs to the solutions. The first is, let's just talk about their small staffs for a moment. That is absolutely one of the reasons that MDIs fail at a rate far exceeding the rate of normal banks.

And that is why in our MDI component of Project REACh, one of the issues we have asked big banks to pledge as part of their participation is not only that they will fund capital inside of these institutions, but that they will also do management rotations and exchange programs so that big banks can send some of their employees to work inside of MDIs, not only so they can learn about MDIs, but so that they can provide boots on the ground in a way that they don't have today. That is a critical component of success.

The second thing has to do with, it is far too hard for banks and especially small banks to onboard technology solutions to outsource some of the functions that they now do manually. We have seen this as an issue in our vendor management guidance where it takes forever for banks to do that, so we will make that easier as well.

Mr. GREEN. My time is up. I have another question, but, Madam Chairwoman, I do thank you for your kindness, and I yield back.

Chairwoman WATERS. You are very welcome.

Mr. Hill is now recognized for 5 minutes.

Mr. HILL. Thank you, Madam Chairwoman.

My best wishes to all of my colleagues. I look forward to being with you next week, and thanks for this excellent panel on a very timely set of topics.

Mr. Quarles, let me start with you and talk about Central Bank digital currency, not something in your bailiwick per se, but very important to financial services and the regulated side of our sector, as well as our economy and American competitiveness.

Dr. Bill Foster and I wrote to Chairman Powell back in 2019 about, is the Fed considering a digital dollar, and we got a note back from Chairman Powell about a month later saying, "Not really." But since that time, Fed Governor Brainard and others have become very active in thinking through the idea of a digital dollar, and, of course, your colleagues around the world are heavily focused on this.

Could you give us an update of what changed? Why is the Fed now recognizing that a digital dollar is an appropriate priority for the Central Bank?

Mr. QUARLES. I think it would be accurate to say that understanding the implications of Central Bank digital currency is something that we have always been focused on at the Fed. It is fair to say that focus has increased over the course of last year. It has increased internationally.

I think we have seen with some of the proposals from a variety of quarters for different types of payment systems that have raised some regulatory and supervisory issues internationally, that has put a premium on our tending to our own payment system, and a Central Bank digital currency could be a part of that solution. So, we are actively engaged in understanding this.

I still think it would be premature to say that we believe that this is a solution that the United States would need to implement. We are doing a lot of research. We are weighing the pros and cons. We have pilot projects in place. And the international study of this is picking up as well. The Financial Stability Board (FSB) will also be looking at this. But this is still in the early stages. It is a very important issue. But I wouldn't say yet we have changed our stance, and now believe that it is something that the United States needs and it is a question of when.

Mr. HILL. I certainly agree it is not imminent, but it is certainly a matter of national security as the world preserves currency, that we consider it. And I commend you for the work that your team is doing with MIT. I think that kind of research is important. But I do believe that this is a critical element for American competitiveness in the years ahead, and I want to urge on the work of the Fed's team.

Let me switch gears to my friend from Missouri, Representative Clay's, line of questioning about the Section 13(3) Facilities and the use of the Treasury's Exchange Stabilization Fund. I heard your answer, but I just want to be clear, so let me ask it a different way: Will the Board of Governors and the Treasury Secretary ask Congress, by some date here just in the next few days, for legislative authority to extend the CARES Act exchange stabilization funding?

Mr. QUARLES. That is not something that we have decided yet, but we are actively considering the pros and cons of that.

Mr. HILL. Do you think that the Fed and the Treasury have adequate resources since the economy is reopening, and there has been very little significant uptick since the height of the crisis back in March on those Facilities, do you think you have sufficient resources under existing 13(3) powers, and the Fed with their existing non-CARES Exchange Stabilization Fund? Do you think that could be sufficient as you look at 2021?

Mr. QUARLES. We don't need new congressional authority to extend the Facilities. It is an existing law that we can extend them. And I am sure you are all aware that there are significant unused resources currently for the Facilities they have. They have served a very useful purpose, but principally as a backstop to private sector activity. But it really would be, I think, a decision for Congress whether those amounts should be supplemented.

Mr. HILL. I look forward to following up with you on this. Thanks for your time. I appreciate the panel.

Thank you, Madam Chairwoman. I yield back.

Chairwoman WATERS. Thank you. And I will now recognize Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Madam Chairwoman. And I would like to just say how pleased I am that you will be the Chair of this committee for another 2 years.

But let me go on and follow through on some questions that actually, Mr. Clay, and I think, Mr. Green, already spoke of. But, Ms. McWilliams, thank you for your willingness to serve our country, first and foremost. And some of you will be going on after January 20th in your positions. There is some overlap. And you are one, Ms. McWilliams.

Before I left my apartment here in Washington this morning, we looked at the cases of COVID around the country, and I looked at the midwest, where I live in, Kansas City, Missouri, and Missouri and Kansas are both blood red in terms of the new cases. It is frightening. I have just been meeting with our hospitals, trying to figure out if we need to prepare for field hospitaling in our City.

So, it is a big issue. And we had over 700,000 people file for unemployment. And based on conversations with Fed officials, I understand that unemployment declines may represent people completely dropping out of the workforce.

So when you consider all of these things, and how we need to have a strong fight against COVID and trying to also recover the economy, are you involved in any way at this point in some kind of engagement with the Biden-Harris transition team so that the FDIC can play its historic role, have it continue without any disruption?

Ms. MCWILLIAMS. Congressman Cleaver, thank you for your kind words, and I am grateful for your service as well, and I look forward to seeing you in the next Congress.

But I will say that we have abided by all of the requirements of government agencies that are imposed on us, and we have certainly engaged to the extent that is feasible and possible with planning, et cetera, for the new Administration starting in January. I have not had any discussions with the Biden transition team.

Mr. CLEAVER. Okay. I am troubled by the fact that—we need to have a seamless move in some of these important areas, and, of course, the FDIC is one of those critically important institutions. Let me ask you, are you preparing for a transition in terms of being able to present the new Administration with information that would allow for the seamless transition that I think all Americans, regardless of their political stripe, would like to see? I don't want you to ignore—I am a little frustrated because I am not sure I understood what you just said. Are you preparing for the transition? Let me just ask you that.

Ms. MCWILLIAMS. I can assure you, Congressman, that any transition to the new Administration is going to be seamless. None of our critical functions are going to be affected. We stand ready to work with whomever is in the White House come January, and you have my commitment that I will work with whomever is on my board, and I intend—I will even share this with you, I intend to fulfill the remainder of my term.

Mr. CLEAVER. Okay. Let me move on. Mr. Quarles, let me follow up on something that my long-time friend and colleague, whom I will miss dearly, William Lacy Clay, with issues that he raised earlier about expanding the lending programs for the Federal Reserve and Treasury. I am a former mayor, and so, I have always—oh, my goodness. I guess my time is up. I'm sorry.

Thank you, Madam Chairwoman. My time expired. I heard the beep, so—

Chairwoman WATERS. Yes, your time has expired, Mr. Cleaver. Thank you very much.

Mr. Emmer, you are now recognized for 5 minutes. Is Mr. Emmer available?

If not, we will go to Mr. Loudermilk of Georgia for 5 minutes. You are recognized. Mr. Loudermilk? Is Mr. Loudermilk on the platform?

If not, we will go to Mr. Mooney for 5 minutes.

If Mr. Mooney is not available, we will go to Mr. Davidson for 5 minutes.

Mr. DAVIDSON. Thank you, Madam Chairwoman.

And I thank our guests for your work in this tough field, and really a period that has seen some important steps by the people represented here today. So, without spending much time, I want to get to as many as I can.

Acting Comptroller Brooks, I want to commend you for the work you have done promoting innovation at the OCC, particularly within the digital asset space. I am particularly encouraged by the OCC's July interpretive letter related to banks being able to provide custody services for digital assets, especially focused on holding the unique cryptographic keys.

I appreciate the approach, and it echoes custody language in my bipartisan bill, the Token Taxonomy Act. Action by the OCC was much-needed, especially as States such as Wyoming, have already provided legal clarity, for example with the special purpose charter for Kraken Financial.

My main concern within this space is that we do not have sufficient legislative clarity and regulatory clarity that will enable digital assets to truly be adopted and to provide the safeguards that markets and consumers and investors need. Do you believe that digital assets could benefit from the certainty that comes from legislation signed into law? In particular, could you address this with respect to the custody issue?

Mr. BROOKS. First of all, Congressman, thank you for the question, and I have always appreciated your deep engagement on these issues going back many years together.

What I would tell you is, on the custody side, I think that clarity around what constitutes a qualified custodian and what assets are permitted to be custody would be a good thing. And I think as you noted in your Token Taxonomy Act, and which some companion legislation kicking around has also recognized, there is a lack of securities law clarity that needs legislation.

At the same time, what we have concluded at the OCC, and this is work that began long before I got here, is that digital assets are analogous to other kinds of assets that have entered the system over the years and that the banking system normally has been the vehicle for transmitting that stuff across the system.

And so, picking up on a discussion that Congressman Hill and Vice Chair Quarles had just a few minutes ago, your basic view is that blockchains are essentially private payment networks. There are other private payment networks in the world, like the Automated Clearing House (ACH) system. That is a private payment network. It is just owned by a very small number of big banks, and it is only open to banks, versus blockchains are payment systems that anybody can join, right. They are open for everyone. They are free and equal to everyone, and in that sense, may be superior, in other ways, to existing networks.

That is really what our work in this space is about, is the recognition that what crypto and blockchain are fundamentally about is changing the way that people interact with each other in the world of finance in the same way that the internet changed the way that people interact with each other for internet information.

And so, I would thank you for your leadership on that. I think that securities clarity and custody clarity would be great as an act of Congress, but I also think that the OCC has a fair amount of existing statutory authority to clarify banks' role in that overall part of the financial ecosystem.

Mr. DAVIDSON. I agree with your viewpoint, and thanks for really clarifying what you are doing and how you view it. I hope my colleagues will take note that there really is underlying support for this, that is not partisan. And I am encouraged by the recent—some of the hearings that we have had in the FinTech Task Force.

So I hope we can continue that progress, and maybe even codify some of this into law. And as you alluded to, securities law, there is certainty that is desperately needed there, and, frankly, sometimes I feel like the SEC is wandering further off course. Hopefully, Hester Peirce will continue to be a voice of reason and people will listen to her more clearly, going forward.

So, thanks for that. I do have to move on to a couple of other topics. We recently launched the Sound Money Caucus with some colleagues, and we are at a period where we are printing money. We are not really borrowing it truly. We owe it. It is borrowed in that sense. It counts as debt. But inherently, that dilutes the value of all of the other money.

So, Vice Chair Quarles, what is your level of concern about the long-term consequences for America's debt, and in a related topic, the size of the Fed's balance sheet? How will we know when we have crossed a limit where we could really undermine the essential liquidity that was able to be provided? We provided some stability. These are all good things. But in the long run, isn't there a level of debt that would be concerning for you?

Mr. QUARLES. I think history would show that for any country, there is a level of debt that should be concerning. The United States is in a special position given our wealth and our status as a reserve currency. So I don't think that is upon us soon, but that is definitely something that as we look at the overall economics and financial situation that we face [inaudible].

Mr. DAVIDSON. Yes. Thanks, and it is hard to state specifically but, the consequence of some of the growth of the Fed's balance sheet is a related way. It was a lifeline, and I think will be a case study for years on the value of a Central Bank in a time of crisis, the last part of March. But there are a lot of regulatory policies that are having some real economic distortion, and I look forward to working with you and others there. Thanks for your work and I wish we had more time to collaborate. And I yield back.

Mr. PERLMUTTER. I think I am up next, but I have to get recognized first.

Okay. I will begin.

To our panel, thank you very much for your service at this difficult moment in American history. I think that the banking system and the financial system has proven itself strong, but I would just state to everybody, we are not out of this. And in Colorado, just as in Kansas, we have seen a terrible spike in the infection rate. A month ago, less than one in 1,000 had the infection. Two weeks ago, we were at less than one in 300; and last week, one in 200.

Madam Chairwoman, I went ahead and started, if that is okay with you?

Chairwoman WATERS. Yes. We had a little technical difficulty. Thank you for getting started. Go right ahead. You have 5 minutes.

Mr. PERLMUTTER. Okay. And so, the infection rate now is less than 1 in 100 in Colorado. Our hospitalizations are higher than they have been at any time since the beginning of this, and we had terrible hospitalization rates back in March and April. Our death rate is starting to rise again, and we thought we had this in hand. This virus is a very nefarious, insidious thing.

And so, to the regulators and to my colleagues, I would say we are not out of this. And as strong as it has been, I think that this pandemic is not over, and it will have a long tail.

Madam Chairwoman, I would like to offer a letter from the Mortgage Bankers Association and other industry partners to be submitted to the record.

Chairwoman WATERS. Without objection, is is so ordered.

Mr. PERLMUTTER. Thank you.

One of the things that Mr. Luetkemeyer and a number of my colleagues have mentioned is that we took certain steps in the CARES Act to make sure that there could be flexibility from the regulators to the banks, from the banks to the borrowers, the landlords, for instance, from the landlords to the tenants. And I think that flexibility is going to have to remain in place.

For instance, we limited the troubled debt restructuring kinds of assets to 6 months for modified loans, and only through the end of the year. So I would ask all of the panelists, do any of you plan to update this guidance to allow these COVID loan modifications to extend beyond 6 months, and extend well into next year, given the state of the pandemic? And I will start with you, Chair McWilliams.

Ms. MCWILLIAMS. Certainly, and thank you for that question. We have worked hard to reach a compromise with the Financial Accounting Standards Board (FASB), and I would say we are willing to do—I can't speak for others, but I will say, I am willing to do what it takes to make sure that our banks can continue to be strong and resilient and that homeowners and small businesses can continue to have access to credit to stay in their homes and operate their businesses.

As with many, many other things, it takes two to tango, and in this case it takes a village of us, and you only have a part of that village here on this panel. We will have to work with FASB to make sure that they also are willing to accommodate the extension of what we have agreed to back in March.

Mr. PERLMUTTER. Thank you.

Mr. Brooks, how about you?

Mr. BROOKS. Congressman, thanks for the question. I echo what Chair McWilliams says, and I guess I would go a little bit further and say that I think that accounting treatment is just one part of the puzzle for banks.

In our world, one of the most important exposures is on the residential mortgage side. And those large banks that I have spoken to, specifically about how they are doing loan modifications and forbearances, tell me that they learned a lot from the Home Affordable Modification Program (HAMP) coming out of the financial crisis, and they understand that even irrespective of accounting treatment, it is better to maximize the net-present value of these loans by keeping existing borrowers in those loans as long as there is a future ability to repay.

So I think that there is a commitment on the part of both banks and regulators to work there. But on the technical issue of TDRs, there is some more to do so with FASB, I agree with that.

Mr. PERLMUTTER. While we are on that subject, in the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act that we proposed, we had some substantial housing assistance pieces in there. My concern is, and I would ask how you look at this from a regulatory standpoint, we have forbearances, or we have moratoria on evictions. But then these tenants are going to have to come up with several months' worth of rent. How do you analyze that? Do you think they are going to be able to do that without assistance from us, the United States Government?

Mr. BROOKS. Congressman, I would say rent is a little bit more complex than mortgage. I think the good news is in the CARES Act, it was fairly clear on the mortgage side that when a borrower comes out from forbearance, the loan is contractually current on the first day out of forbearance.

Mr. PERLMUTTER. Yes, but let me stop you. But the landlord is eventually going to have to pay the bank, and you are eventually going to have to analyze that bank.

Mr. BROOKS. Yes. That is my point, that rent is more complicated, and I think it is worth looking at it legislatively, as you say.

Mr. PERLMUTTER. Okay. Thank you.

And thanks, Madam Chairwoman, for the time. I yield back.

Chairwoman WATERS. Thank you.

Mr. Emmer, you are now recognized for 5 minutes.

Mr. EMMER. Thank you, Madam Chairwoman, for hosting this important hearing during this uncertain time. As we close out the 116th Congress, we have a lot to be thankful for because of the nonpartisan efforts to educate and inform Members on the financial technology issues on the FinTech Task Force. I want to take a moment to thank Representative Lynch for his efforts in leading the task force.

As we have seen over the past 2 years, fintech issues are only rising to higher prominence. It is my hope that next Congress, we will continue that nonpartisan dedication to fintech issues, whether that be on the task force or an even stronger focus on the issues through perhaps a subcommittee. One thing is for sure, the opportunities that fintech innovations present for all Americans and, indeed, the entire world are not going away. Thank you to both sides of the aisle for their ongoing focus on these issues.

And thank you also to Vice Chairman Quarles, Chairman McWilliams, Chairman Hood, and Acting Comptroller Brooks for all of your work over the past couple of years. In particular, Mr. Brooks and Chairman McWilliams, you have both demonstrated a strong commitment to crafting a regulatory environment that encourages innovation and growth in the fintech space. As we know, with more competition, products, and services in banking, the American people are afforded with more choice, fairer prices, and control over their financial future.

Chairman McWilliams, thank you for dedicating resources to developing a financial technology strategy that works with industry to craft smart and considerate regulations for financial technology, allowing more consumers to access the banking system. And, Mr. Brooks, thank you for providing the necessary certainty for banks to provide custody of cryptocurrency assets, and all you have done to ensure that the Federal Government remains supportive of new technologies and is capable of adapting regulations to suit our country's continuing investments in innovation. I am hopeful that additional regulators will come on board and provide support for these technologies.

Vice Chairman Quarles, Chairman Powell informed us in a previous committee hearing that private sector individuals and innovations may not have a place in the Fed's consideration of a digital dollar. This is concerning. So far, private actors have been responsible for the entirety of these innovations and are advancing implementation of these technologies with or without the Fed. I urge the Fed to make additional efforts to make public their considerations regarding the digital dollar and to involve private sector innovators to craft a digital dollar that is sound, safe, and protective of individual privacy.

Acting Comptroller Brooks, during your short but impactful tenure at the OCC, you have made extraordinary inroads into providing guidance necessary for OCC-regulated financial institutions to engage with digital assets such as Bitcoin and Stablecoins. What difficulties or obstacles do you encounter when promoting regulatory or supervisory guidance related to digital assets to OCC-regulated financial institutions, and how can that be improved? And I guess when you are done answering that, I have a couple more for you.

Mr. BROOKS. Congressman, first of all, thanks so much, and thanks so much for your partnership on this over the years. I really do appreciate your vision, and it is great to be part of this team.

What I would tell you is on the institution side, there are very few impediments. You can see that very, very shortly after we gave our guidance on crypto custody, the nation's largest bank, JPMorgan, announced it was going to launch a crypto custody business in partnership with Fidelity Digital Assets, which is the crypto arm of Fidelity Investments, a company that we are all familiar with. This recognizes the fact that somewhere between 50 and 60 million Americans own this stuff. And some of us might be excited about it, and some of us might be less excited about it, but the point is, a gigantic proportion of our society believes it is the future for various reasons. That part is important.

I think the other thing that is a bit of a challenge is, as a country, we haven't yet recognized the important competitiveness aspect of this. When you see that China has already issued the e-Renminbi—China has adopted a digital currency of their national fiat currency that is now transacting on a blockchain—and in this country, we are still years away from a national real-time payment system, I come to the conclusion that you come to, which is that the best solution is to win the way America has always won, by unleashing the power of our innovative, dynamic, risk-taking private sector. We have built private Stablecoins in this country that already have a market cap in the tens of billions of dollars. These things are transacting daily, they are growing rapidly, and they are used for broad commercial purposes.

I don't think, in this country, we need to wait to build a command and control government solution. I think the private sector is on it, and I think the role of the regulators on this panel is to provide a framework to make sure there aren't bank runs or other problems that consumers would be affected by. I am sorry for eating up your time.

Mr. EMMER. That is okay. Thank you. I look forward to continuing the conversation.

Thank you, Madam Chairwoman.

Chairwoman WATERS. Mr. Himes, you are recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman, and a hearty welcome back to my colleagues on the committee. I look forward to working with you. And welcome to all of our regulators. It is good to see you, too.

I cut my teeth in the Congress starting in 2009, when we were experiencing a just brutal meltdown of another type, very different, of course, than what we are seeing today. But I think what we are seeing today, the economic effects of the pandemic and the economic shutdown, therefore, is not something we would have predicted.

And to give credit where credit is due, I appreciate the actions that you have taken, especially the Federal Reserve, working with Treasury, with the authorities granted to it by the Congress under the CARES Act. My hope is that this was handled well.

I give credit where credit is due to the Dodd-Frank Act, too. I was a freshman when we crafted that legislation. And when it was done, it was appreciated by pretty much nobody on the left or the right, but here we are where the dog that didn't bark, of course, was a major dislocation in our financial system despite the dramatic dislocation to our economy.

So, Mr. Quarles, my questions are to you, and hopefully I will give you enough time to answer them. Obviously, the crisis has uncovered a number of things that are concerning, and I would like you to, if you would, just address each one. And, obviously, you won't be able to do so comprehensively, but if you could try.

Number one, the dislocation in the Treasury market in mid-March gave an awful lot of us heartburn. Number two, a number of you have mentioned concerns with the commercial credit market. Could this be something that at the end of the day, causes a significant problem within the banks? And then, if COVID has done one thing, it has really uncovered the disparities that exist in our society. And while I have heard a lot of back and forth, I actually haven't heard the regulators offer suggestions on how we might increase the bank population and make credit available to more Americans.

I know that is a tall order, Mr. Quarles, but you have the remainder of my time to address those three issues.

Mr. QUARLES. Thank you. Thanks for that, and I will be brief. I could take the remainder of the hearing on those three issues.

On the Treasury market, there clearly was dysfunction in March. It was severe dysfunction for a few days that was caused by the Treasury market trading infrastructure essentially being overwhelmed by sales orders on the parts of many different participants. You had a variety of people who were looking for cash liquidity, given the severe uncertainty that there was in the middle of March, and that overwhelmed the infrastructure of the systems' ability to handle that.

We are currently looking at a variety of factors. We are working multilaterally with other domestic agencies. We are working internationally because this was a problem internationally. One of the significant issues was foreign sellers selling in order to get dollars for their dollar needs in this time of—in this dash for cash. And I think that there are things that we will need to look at about the structure of the Treasury market in order to improve its operation under stress. It would be premature to say what they would be.

The commercial credit market—given the nature of this stress, an element of the solution has been increasing debt on the parts of many companies that had severe revenue restrictions in the spring. The corporate sector was already reasonably highly indebted going into this, and so that is something we need to look at. We are running bank stress tests currently to see how we think that could roll up into the financial system. Those will be very granularly run, and we will release in the middle of December results for each bank, public results of how they performed in this, that I think will give us more clarity into that issue.

On disparities, just to be very quick, I think that the actions that we have taken at the Fed to improve a more rapid return to economic health—and we aren't there yet, obviously. We have learned at the Fed, over the course of the last few years, that when we allow the economy, and particularly allow the unemployment rate to fall faster and to fall further than the Fed has been comfortable allowing it in the past, that benefits particularly those who are most disadvantaged in society, and that is something that we can do. The Fed doesn't have a lot of distributive tools, but we have seen that there are distributive effects to that that are important. And that was one of the reasons why we changed our framework as we did recently announce.

Chairwoman WATERS. Thank you. The gentleman's time has expired.

Mr. Loudermilk, you are recognized for 5 minutes.

Mr. LOUDERMILK. Thank you, Madam Chairwoman. I appreciate the opportunity to be online with you here today.

And, Vice Chairman Quarles, let me first thank you for aligning the Fed's supervision with the tailoring regime by applying Large Institution Supervision Coordinating Committee (LISCC) only to Category 1 firms, and moving smaller and less risky firms into the large and foreign banking organizations with provision portfolio. I think this rightly refocuses the LISCC supervisory portfolio by recognizing substantially reduced size and risk of Category 3 firms and does not change the capital liquidity requirements for firms not in the LISCC portfolio. We really appreciate your efforts there.

On another topic, lenders did an outstanding job of issuing PPP loans to support small businesses and their employees, but PPP loans remain an asset on lenders' balance sheets until the loans are forgiven, and forgiveness is taking longer than we all expected. That means a number of financial institutions are on the verge of crossing an asset-based regulatory threshold because of PPP loans which are guaranteed by the SBA and are designed to have a zero credit risk to the lender. I recently sent a letter with 13 of my colleagues on this committee asking you all to address this issue.

I also introduced a bipartisan bill with Congressman David Scott that would exclude PPP loans from asset-based regulatory thresholds of $10 billion and under. Madam Chairwoman, thank you for including the bill in our discussions during this hearing today.

Chairman McWilliams, I appreciate that the FDIC has addressed the $500 million and $1 billion asset thresholds, and I hope you can address the others.

Chairman Hood, thank you for addressing this issue for credit unions.

Now, to my questions. Acting Comptroller Brooks, I understand the banking agencies are discussing how to proceed with this on an interagency basis. Can you share what you are planning?

Mr. BROOKS. Yes, Congressman, and thank you for the question. We are not final on this yet, but I can definitely give you some parameters of what is being discussed amongst us. The idea is there are, first of all, the need to identify each of the asset thresholds that trips you into a new regulatory regime, and there are many of them, just being the government. So, there is a threshold at $500 million, a threshold at $600 million, a threshold at $1 billion and $2.5 billion and $10 billion, et cetera.

The basic parameters, I believe, are that for a period of 1 year, which could, of course, be extended by the agencies, but to Vice Chair Quarles' point earlier, we want to get to normal as soon as we can get to normal. So for a period of 1 year, we would exclude PPP assets from each of those asset thresholds, up to and including the $10 billion threshold but not above that. Our theory is that we want to do surgery here. We don't want to act with a meat cleaver. We want to be very careful, and we don't want to dislocate the agency's ability to manage risk, but I think that we will settle out somewhere pretty close to that.

Mr. LOUDERMILK. Okay. We appreciate your efforts, and if you could please keep us updated as you move forward, because you are right, there is a myriad of regulations and tripwires along the way.

Vice Chairman Quarles, does the Federal Reserve plan to address these regulatory thresholds?

Mr. QUARLES. Yes. There is an active—we are obviously engaged in very active interagency discussions, and I would subscribe to what Comptroller Brooks said and I think we will have something to report pretty quickly, actually.

Mr. LOUDERMILK. Okay. I appreciate that, because a lot of the small banks are really left hanging out there. We actually have a bank in our district. It has two branches, a small bank, which issued more PPP loans than one of the largest banks in the nation did nationwide. And so, you can see how that could really negatively affect this bank that stepped up. It is Vinings Bank. They stepped up, and they took on a lot because they are a community bank, and their community was riding on the needs of having these PPP loans.

And my final question is, Chairman McWilliams, do you anticipate that the FDIC will provide additional relief as well?

Ms. MCWILLIAMS. Yes. We have already excluded PPP loans from the deposit assessments for banks, but we are now working with the other regulators as mentioned to make sure that we—to the extent that we don't have the clear statutory authority to change thresholds, to maybe freeze the total consolidated assets as of a prior date for those thresholds. So we are trying to be, I would say, as flexible as possible to make sure that banks have a venue to proceed with helping stimulate the economy and make sure that borrowers can stay in their homes.

Mr. LOUDERMILK. Thank you very much. Because I mentioned this has been a collaborative effort between the private industry and government as well, and so we need to make sure that we are covering them as well.

So, Madam Chairwoman, that is all the questions I have. I know it is unusual for me to yield back time.

Chairwoman WATERS. Thank you. I appreciate it.

Mr. Foster, you are recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman, and to our witnesses. And I would like to get started by just seconding the comments of my colleague, French Hill, regarding Central Bank digital currencies.

Vice Chair Quarles, you just spoke and have spoken before about the dysfunction that occurred in our Treasury bond markets in March, and noted that the sheer volume in that market may have, "outpaced" the ability of the private market infrastructure to support stress of any sort there.

Under normal circumstances, the Treasury market is the deepest and most liquid fixed income market in the world. It serves as a critical benchmark for the mortgage corporate loan and mini bond markets that are essential to the flow of credit in our economy, and it allows the U.S. dollar to operate as the world's dominant reserve currency. And that is why it is crucial that these financial pipes continue to function well, even in stressed and volatile conditions, and especially as we continue to fight COVID-19 and work to provide fiscal relief to millions of struggling families and small businesses.

Now, when the Fed has to step in to support the markets for Treasury bonds, I view it as sort of the financial equivalent of our military going to DEFCON 2. When that happens, it is our duty in Congress to see what sort of technical changes could prevent this in the future.

One straightforward solution to this issue would be a simple requirement that all secondary market Treasury transactions be subject to central clearing. Today, participants in the markets for Treasuries face a centrally cleared counterparty in less than a quarter of all transactions. By comparison, because of the Dodd-Frank Act, central clearing covers virtually 100 percent of the exchanged traded derivatives and equities and a majority of the swap market transactions. And despite a fair amount of squealing at the time, I believe that this is now widely viewed as one of the many successful reforms of Dodd-Frank.

So, Vice Chair Quarles, could you explain to us your view of why requiring central clearing of Treasuries might be beneficial to market functioning? And what are the drawbacks and tradeoffs, if any, of this approach?

Mr. QUARLES. As we look at the lessons from the Treasury market in March, we have been looking closely at this issue of central clearing of Treasuries. The advantage would be that central clearing would reduce pressure on dealer balance sheets. The current system requires the dealers to basically take those Treasuries onto their balance sheets, and when there isn't another side to the trade, that is obviously a significant strain.

The cons are really the cons of any [inaudible] It is a complex risk management problem. And so, we want to think that through carefully for a market that is as large and as central as you have correctly identified the Treasury market as being. The pros are attractive. We are looking through this carefully with an interagency group.

I would say just as an additional thought, though, that could lead to improved Treasury market functioning generally. What we saw in March, though, was simply that everyone was selling and no one was buying. And there was a period of a few days when there just wasn't another side to the transaction. So, a smoother mechanism for matching buyers and sellers probably would not have addressed the March issue because the question was that there just wasn't a buyer. But that doesn't mean that it is not a useful wakeup call for thinking about the structure of the Treasury market in that particular situation.

Mr. FOSTER. So you anticipate for situations like that, there is no substitute for having the Federal Reserve have some pathway in to support things? And is there a merit, if we have to go down that road, to actually have a legislative clarity on the circumstances and making sure that the taxpayer is never on the hook in that sort of intervention?

Mr. QUARLES. Let's hope that situations like that are as rare as this one was, which is once a century, if not longer. I think the Fed has the authority to do what it is that we need here and that our strong and reasonable expectation is that something like this is not going to be repeated in our lifetime.

Mr. FOSTER. Well, my goal is to die before we ever have a crisis like we have been going through. So, thank you. My time is up. I yield back.

Chairwoman WATERS. Thank you very much.

Mr. Mooney, you are recognized for 5 minutes.

Mr. MOONEY. Thank you.

So, direct questions for Vice Chairman Quarles. Let me just start by saying that insurance is normally State-run, and so, Vice Chairman Quarles, under the oversight of the Financial Stability Board, they have adopted a holistic framework to identify and proactively address systemic risk in the global insurance market. Can you explain how the U.S. insurance regulatory regime has performed in minimizing systemic risk, and more specifically, how this performance compares to other regulatory systems for insurance around the world?

Mr. QUARLES. I think we have seen in the current stress, which has been severe, that the insurance industry, which is regulated by the States in the United States and has been since the McCarran-Ferguson Act, has performed quite well. And, in general, over the history of our industry, compared to industries abroad and other forms of regulation, I think that regulatory system has stood up well. It has passed the practical test of what works.

As we look at insurance regulatory reform more broadly, which the International Association of Insurance Supervisors (IAIS), which is a member of the FSB, is considering in the United States, the so-called team in the U.S., which is the Federal Reserve and the National Association of Insurance Commissioners (NAIC) and the Treasury, have worked to ensure and have been successful in ensuring that there is scope in that process for the U.S. system to be recognized internationally, and I expect we will [inaudible] process comes to completion several years from now.

Mr. MOONEY. That kind of leads to my follow-up question. I agree with you, first off, that it has worked well and the States regulating it and we have worked well, better comparable to other countries. But given that our U.S. insurance regulatory system produces comparable results to foreign frameworks, how is the Federal Reserve planning to make the case that the American system is, "outcome equivalent," with the IAIS insurance capital standard?

Mr. QUARLES. There is a monitoring process that is going on at the IAIS of their proposed global standard. We have created space in that standard for the U.S. framework to be viewed as equivalent as a solution that works within the IAIS project. That monitoring process has a fair ways to run yet. It will be incumbent on us in the United States to put forward a well-articulated framework for how a global consolidated insurance regulatory framework could work.

The Fed has done its piece with respect to our building block approach for how insurance companies that include a depository institution can be regulated. The NAIC is working hard on its group capital approach, and again, I am pretty confident that as we put those forward in the international discussions, the equivalent will be viewed positively and that the effort will be successful.

Mr. MOONEY. Thank you, Vice Chair Quarles.

And let me just close—I don't know how much time I have left. Let me just close by saying, as we discussed, here in the United States, insurance has been regulated primarily at the State level for over a century, so, "If it ain't broke, don't fix it." We have a system that works well here. The needs of West Virginia are different than the needs of Massachusetts and California. You can't have a one-size-fits-all standard that is going to work in this country. If we are forced to adopt an insurance capital standard at European centric set of rules for—

Chairwoman WATERS. The gentleman's time has expired.

Mrs. Beatty, you are recognized for 5 minutes.

Mrs. BEATTY. Thank you. Madam Chairwoman, let me start by thanking you for your stellar leadership, for all of the work that we have gotten done during this very difficult time, a difficult time in this nation, and certainly as we have been confronted with COVID-19, all of the work that we did in helping save lives, through what we have gone through with our economic problems and with PPP and housing. I just think it is very important for me to recognize your work.

With that said, to our witnesses, thank you for being here today.

Many of my colleagues have talked about where we are, and related it to the problems we have had or the successes that we have had with PPP. We have also talked about the greater financial portfolio. We have talked about capital and liquidity and, certainly, access to capital. But as I look to the title of this full committee virtual hearing, we talk about oversight, and we talk about it as it relates to the departments that our witnesses oversee. We talk about it, as we should, in ensuring safety and the soundness of diversity.

Certainly, you all know, as Chair of our Subcommittee on Diversity and Inclusion, I like to devote much of my time to that, because I think it is most appropriate when we talk about the economic downturn, when we talk about the COVID-19 crisis, and we talk about social injustices. Why? Because when we look at the disparities and how African Americans and others are disproportionately affected, it is a clarion sound bell that is in the financial services area.

Mr. Brooks, I am going to start with you, and this will be very quick. All of the other witnesses have been asked this question. I take great honor that I have had the opportunity to be in the forefront with the Offices of Minority and Women Inclusion (OMWIs), so I don't want to break my tradition by not asking you, do you know what OMWI is, have you met with your OMWI Director, and who is your Director?

Mr. BROOKS. My Director, Joyce Cofield, I consider to be a close friend and mentor. She and I meet for an hour every single week and have really leaned into a number of important initiatives here, which I am happy to talk about if you like.

Mrs. BEATTY. Thank you very much. She has done a great job on that.

Let me go to my next question. And, if so, we can come back, or offline, I can ask you some things.

I was very disturbed when, on September 22nd, the President issued Executive Order 18950, which seeks to halt certain forms of diversity and inclusion training in contracting with programs in the Federal Government. So to each one of you, yes or no, are you familiar with this? And the second question, yes or no, have you ceased diversity training in your department?

I will start with you, Mr. Quarles.

Mr. QUARLES. Thank you. I am somewhat familiar with it, although that order does not apply to the Federal Reserve, given the nature of the agency, and we have not changed our practices.

Mrs. BEATTY. Thank you. And while independent agencies don't necessarily have to comply with the Executive Order, we also know that many of you have been known to voluntarily comply with the order.

Mr. QUARLES. We haven't changed our practices with respect to diversity.

Mrs. BEATTY. Thank you.

We will just go down the line. Mr. Brooks?

Mr. BROOKS. I am familiar with the order. We are obviously a unit of the Treasury Department. There is a review process for our diversity programs, but we continue to provide diversity programs that don't run into any of the issues in that order. For other things, we go through a review process as required by the order.

Mrs. BEATTY. Okay. Thank you.

Ms. MCWILLIAMS. And I will say that like the Fed, we are an independent agency, and we generally comply with the spirit of the Executive Orders. We have been able to continue our diversity in training as we have done in the past.

Mr. HOOD. Representative Beatty, at NCUA, we often strive to comply with the spirit of Executive Orders. In this case, this has been turned over to our general counsel for review, but I assure you we are continuing to have outreach and engagement opportunities. In fact, I have spoken at over 20 diversity, equity, and inclusion events, especially following the murder of George Floyd. It has been my responsibility to ensure that our employees have a safe space to talk and hear from me directly during this challenging time.

Mrs. BEATTY. Thank you very much.

I yield back my remaining 5 seconds.

Mr. GREEN. [presiding]. Thank you. The gentlelady's time has expired.

Mr. Budd is now recognized for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman.

Just to clarify, I heard a mention earlier in this hearing about President-elect Biden. To my knowledge, none of the States in question have certified their results, and their State electors have met, so there is really no President-elect. So we are asking for the same courtesies and the legal processes that were extended to Vice President Gore in the year 2000 be extended to President Trump in 2020.

As you are aware, Democrats lost seats in this body, and that is evidence enough that the American people recognize the failure of the far left socialist policies. Now, this gives me concern regarding the next Congress, but we have several opportunities before us to seek more bipartisan solutions and to reject the extreme.

So, I want to thank the panel for being here. And as we continue to weather this pandemic, I appreciate that you and all of your agencies have worked with our banks and our credit unions to provide some flexibility so that they can provide access to credit and financial services to creditworthy consumers and creditworthy businesses. All of you have shown your ability to work with our banks and credit unions, but it is now time for Congress to help out those consumers and those same businesses as well.

And that is why I am pleased to be an original co-sponsor of H.R. 7777, the Paycheck Protection Small Business Forgiveness Act. This bipartisan bill would not only help millions of small businesses by forgiving all loans under $150,000 with a simple, one-page forgiveness form, but it would also free up countless hours and resources for our banks and our credit unions, allowing them to focus on the core of banking: providing access to credit and financial services to individuals and businesses. As a result, some banks are crossing asset thresholds that subject them to greater regulatory burdens.

So, my question is this: What are you all doing to ensure that these financial institutions aren't faced with potentially costly regulatory burdens just because they helped with implementing a relief program? Chair McWilliams, I will start with you in reference—I think you may have made some comments to my colleague, Mr. Loudermilk, in relation to that, so I will start with you, Chair McWilliams.

Ms. MCWILLIAMS. Sure. We are doing a number of things to make sure that these thresholds do not provide a disincentive for banks to engage with their borrowers, individual consumers, and small businesses. We are going through an interagency process to ascertain what all we need to do to address those thresholds and to make sure that banks need to do what we want them to do, which is continue to stimulate the economy and be there for their consumers and customers.

And with respect to the FDIC, we have also done a number of things, including a change in what counts for the audit purposes thresholds as well as excluding PPP Facility assets from the deposit assessments for banks that have engaged in extensive PPP lending.

Mr. BUDD. Thank you very much.

Comptroller Brooks, if you would, please comment on that?

Mr. BROOKS. Congressman, thank you for the question. I would endorse what Chairman McWilliams said; we are obviously part of the FDIC's process on that.

The one other thing I would comment on is, like the other agencies, we excluded PPP assets from our assessments of the first half of the year, and we also adopted a supplemental leverage ratio of rule with the two other banking agencies to make sure that banks could exclude pandemic-related deposit inflows from messing around with their capital ratios and with their leverage ratios. I think all of those things create a safe space for banks to proceed.

Mr. BUDD. Thank you.

Vice Chair Quarles, during your testimony earlier this week on the Senate side, before the Senate Banking Committee, you were asked about the Fed's plan to extend the exclusion that was made for the supplementary lending ratio (SLR) to the global systemically important bank (G–SIB) surcharge in order to ensure that capital is not increased at the end of this year. I think your response to that question was that the Fed has not heard concerns about this from the impacted banks. So, I am looking for clarification to that response, because as I understand it, the Fed has discussed the likelihood of a capital increase with the banks themselves.

I am sure you are aware, along with every Republican member of this committee—we sent you a letter requesting action on this because we have been hearing from the banks that an increase in the G–SIB scores could impact their ability to support the economy when we need it most. Any comments on that?

Mr. QUARLES. Yes. The way the G–SIB calculation works—and I didn't get into this with the Senate, but it is probably good that you have given me the chance to do that here. The way the G–SIB calculation works is that there is not an immediate capital consequence for a firm going over, moving up a bucket in the G–SIB framework. Instead, that capital consequence would take place after a year. And the framework is designed specifically so that temporary changes would not have the effect that you and we are concerned about here. This will give us the chance, if we think that the changes are likely to be durable, to consider whether there should be adjustments made over the course of time.

So, what I was saying was that there is not an immediate capital consequence. We are not hearing that there is an immediate capital consequence, that is not how the framework works, and we have time to think this through should we discover that the effect is going to be more durable.

Mr. BUDD. Thank you. I yield back.

Mr. GREEN. The gentleman's time has expired.

Mr. Vargas of California is recognized for 5 minutes.

Mr. VARGAS. Thank you very much, Mr. Chairman. Can you hear me?

Mr. GREEN. Quite well, Mr. Vargas.

Mr. VARGAS. Thank you. It is a pleasure to be here again.

And I want to thank all of the witnesses today. I appreciate very much their testimony. It is a very difficult time, and I think they are working very hard on behalf of the American people.

Now, I have to say, at the beginning of this hearing, we Democrats were lectured on the issue of divisiveness, and now we were just lectured on the notion of who won the election. I think that we won, not only at the President level, but also at the congressional level. So I find it interesting that somehow the winners are the ones who are saying we were somehow rejected by the American people when we won.

I would also remind people that 4 years ago when Mr. Trump was running for President, and Mr. Trump won about the same amount of electoral votes as Vice President Biden has now, we didn't like it, but of course, we acknowledged it and we had a transition. Now, to hear that we are in the same situation and we are not supposed to acknowledge that Vice President Biden has won is really rather ridiculous, just to be frank.

Also to divisiveness. I have to say this. I have been on this committee for 4 years. From he previous chairman, all I heard was divisiveness, mostly around the issue of Dodd-Frank, and other things too but especially Dodd-Frank; it was demonized, in particular. And I think I heard today from the witnesses how well Dodd-Frank has worked. Did I mishear or did I hear correctly that Dodd-Frank, in fact, was very beneficial during this time?

Vice Chair Quarles, why don't you respond to that? Has it been helpful, Dodd-Frank?

Mr. QUARLES. I think the increases in capital and liquidity that were put in place after the 2008 crisis have been very helpful.

Mr. VARGAS. Anyone else disagree with that? How about Acting Comptroller Brooks?

Mr. BROOKS. No. I would echo the Vice Chairman's comments.

Mr. VARGAS. Now, I have to say, that was—when I first got on this committee, it was a far left sort of bill. They told me how unhelpful it was going to be, and I believe most of you were appointed by President Trump. So anyway, I—again, what becomes demonized and far on the left all of sudden becomes very helpful in the middle. So, again, I hope that we can work together and get away from this divisiveness and name calling. I don't think it works. And I do think we have a lot of work to do together, and we should work together.

Now, I do have some concerns about COVID-19 and where we are today. COVID-19, of course, is a virus, and this virus, as all viruses, has seasonality. In fact, recently, I think one of the medical groups said that you would see during the summer, a diminution of COVID, and then in the autumn, it would come back, and then in the winter, it would spike. I am very concerned about where we are here.

In fact, recently here, very recently, I heard from both Jerome Powell, the Fed Chair, as well as Christine Lagarde, the president of the European Central Bank, that they are very concerned too about this. Could you comment on that? Because I do have great concerns that this is roaring back and we are going to be in trouble.

Mr. Quarles, don't you comment first? Were they wrong?

Mr. QUARLES. I think there is a great deal of uncertainty about how the situation will evolve, and so we shouldn't be complacent about that as [inaudible] ability and within the Fed's [inaudible] economic support as well.

Mr. VARGAS. Mr. Brooks?

Mr. BROOKS. Congressman, I think that the watch word here is, "uncertainty." There is a lot of negative information out there, including increases in cases and hospitalizations. There is also a lot of positive news out there, including the approval of new therapeutics, the reduction in the length of hospitalizations, and effective vaccines. So, I think a lot of it depends on our reaction to it at this point.

Mr. VARGAS. I think that they took that into account too when they commented. In fact, they still say the uncertainty is something that worries them.

How about Chair McWilliams? What do you think about that? I don't know if you heard their statement, but their statement was concerning to me.

Ms. MCWILLIAMS. We are certainly monitoring the conditions on the ground to make sure we understand what related business closures may be happening in different jurisdictions. We are working closely with our regional offices to make sure that we are appropriately addressing any issues that may come up for our banks that are trying to help consumers stay in their homes and small businesses continue to operate. So, I would say that certainly we are very careful about analyzing the numbers and understanding what our regulatory response should be.

Mr. VARGAS. Thank you.

I guess my time has almost expired. What I would say is, let's try to work together. I think that is important. And let's get away from this divisiveness. Let's acknowledge what happened, too, in this Presidential race.

Thank you very much, Mr. Chairman. My time has expired.

Mr. GREEN. The gentleman's time has expired.

Mr. Kustoff is now recognized for 5 minutes.

Mr. KUSTOFF. Mr. Chairman, I want to thank all of the witnesses for appearing today. And I do want to echo the comments of the ranking member and so many others this afternoon, who have talked about the incredible work that all of you have done, the witnesses, in protecting the soundness of our financial system over these last 8 months. I think you have probably given a lot of stability to people across the nation. You provided relief to businesses that, frankly, have struggled initially, and to those individuals who struggle. So, thank you for all of your hard work.

Comptroller Brooks, back in May, the OCC completed and updated the Community Reinvestment Act. Obviously, these were important changes that were made that weren't trivial changes. It was a complete regulatory overhaul.

Under the new framework, banks are going to be assigned a CRA grade based on whether they meet certain benchmarks and community development minimums. But when the rule was adopted, the OCC didn't necessarily define what the benchmarks would be. As I understand it, and the way I interpret it, you wanted a separate rulemaking process for setting those benchmarks.

Now, of course, here we are about 6 months later, and the OCC still has not started the second rulemaking process. Can you talk to us about your plan, what the OCC's plan is, and how you are going to provide banks with the certainty regarding their responsibilities under the regulation?

Mr. BROOKS. Congressman, absolutely, and thank you for that question.

First of all, I would tell you that we are just a few days away from releasing the notice of proposed rulemaking on performance standards, so you will see that very shortly, I would expect by next week. In terms of the work that we have done, one of the things that we were able to do after adopting the original CRA rule was to bring on board one of the world's leading banking economists, Dr. Charles Calomiris, to lead our economics function. And Dr.

Calomiris has had a significant role in helping us think through what the performance assessments ought to look like.

So, the onboarding of a new economics leadership team has been one of the reasons it took us a few extra weeks beyond what we would have hoped. But the good news is, we now have that level of input to make sure we get it right.

What I can tell you that you will see in the rule when it comes out in just a few days is a couple of things. First of all, we are going to be moving from a highly relativistic standard under the old rule, where we basically had banks compete with each other to see who got the A grade, so it was both subjective and relativistic. And we are hoping to move toward a more objective and predictable kind of standard so you will know that you have to hit this threshold in order to get an "outstanding," this threshold in order to get a "satisfactory," et cetera. That is a significant change from in the olden days. The way that I like to put it is we want to see CRA as more like a math test and less like an English test. "Satisfactory" shouldn't be in the eye of the beholder; it should be predictable so banks know how to meet what we expect of them.

And the other thing we have said is that we will be holding banks accountable for meeting or exceeding their previous levels of CRA contributions. We know that one of the concerns expressed by commenters in the original rule was that somehow our new framework was going to result in a reduction of CRA activity. We are confident it isn't, and the performance standards will speak to that issue in terms of who gets a pass and who doesn't.

Mr. KUSTOFF. Thank you very much. I appreciate that.

Vice Chairman Quarles, there was some discussion earlier, during questioning from Congressman Barr about de novo banks. And I think we are all concerned that we have not seen the creation of de novo banks over the last 10 years, like we did prior to 2008. If you can, just to set the stage, what are the primary factors that led to the lack of de novo banks over the last decade? And what, if anything, can we as Congress do to facilitate de novo banks?

Mr. QUARLES. I think the primary factor is more of a question of mindset. There had been, leading up to the 2008–2009 crisis, a significant spate of de novo banks approved, particularly in some jurisdictions. Many of those banks failed, and that has resulted in a caution over the course of the last decade in the regulatory system generally about the approval of de novo banks.

Myself, I think that is a little bit of a question of a matter of a cat that sat on a hot stove. It won't do it again, but it won't sit on a cold stove either, and that there are things we can do and have done to improve and streamline the regulatory environment for small banks to help make, establish [inaudible].

Mr. GREEN. The gentleman's time has expired.

Mr. Lawson of Florida is now recognized for 5 minutes.

Mr. LAWSON. Thank you very much, Mr. Chairman. And I would also like to thank the panel on the Hill for this discussion today.

I know that there have been a lot of things that have occurred since we have been through this pandemic, and so I want to ask Vice Chairman Quarles, the Federal emergency COVID-19 Facilities are created to support a broad cross-section of the financial market and economy supporting the availability of credit for households, small and medium-sized businesses, to maintain their payroll and employees through new and expanded loans providing credit to larger employees so that they are able to pay supplies and maintain their business operation. However, the Facilities are set to expire at the end of 2020.

Do you know if the Fed and the Treasury has already created a plan to help these businesses maintain on their feet and meet payroll, as COVID will still be a concern next year?

Mr. QUARLES. Certainly, the Section 13(3) Facilities that we put in place in conjunction with Treasury have been very helpful in restoring market function and the availability of credit across a broad swath of the economy, as you note. The question of whether, in light of the performance of the economy since the spring, they should be extended, is one that we are currently engaged on.

And while the economic progress since the spring has been better than many people, including we at the Fed, expected that it might, we are still a long ways away from being on the other side of the COVID event. Unemployment is too high. Small businesses are under credit pressure. So, we want to take all of that into account as we consider this question. We haven't made a decision on it yet. We are talking with Treasury about it, but obviously, we need to decide that before the end of the year.

Mr. LAWSON. Okay. Thank you. And it will be interesting to see what happens with your conversation with the Treasury, because it is a major problem. When I travel throughout my district and so forth, I get more questions about that than anything else, because there are still a great deal of dilemmas there.

But, Mr. Vice Chairman, I have one other thing. In September of 2020, the Fed banned stock buybacks and constrained dividends payment by large banks to safeguard their wealth against COVID-19. However, I think, is it safe to say that the Fed officially doesn't want to repeat the history by using government funds to capitalize banks rights? So why did the Fed prohibit dividend payment entirely, given the economy activity will likely be constrained until the pandemic is over?

Mr. QUARLES. Thank you for that. As you note, we did constrain dividends. We prevented them from being increased [inaudible] An income test. Most importantly, we prohibited share repurchases, which is for our large banks, how 70 percent of their capital distributions are made. So, the great bulk of capital distributions have been suspended.

The result of that is that during this COVID event, even while the banks have been taking very large provisions, particularly in the second quarter for expected credit losses, capital at these institutions has actually increased. It increased in the second quarter and it has increased in the third quarter.

We are now running detailed stress tests with two different scenarios, given the uncertainty as to how the world might evolve. And we will release publicly the results of those stress tests before the end of the year, which will give us much more insight into the banks' resilience in light of the economic circumstances that we are facing. And then we will make a decision as to whether we should extend or modify in any way the capital constraints that we have implemented.

Mr. LAWSON. Okay. Thank you.

And, Mr. Chairman, with that, I yield back.

Mr. GREEN. The gentleman yields back.

Mr. Hollingsworth is now recognized for 5 minutes.

Mr. HOLLINGSWORTH. Good afternoon. I want to thank all of the panelists as well for being here today. My first question goes to Mr. Quarles. I know Mr. Budd touched on this a little bit earlier, but I want to come back to it and put a finer point on it. I was, admittedly, a little bit stymied, I say respectfully, by your answer to Senator Rounds yesterday when he asked about the G–SIB surcharge and some of the effects that our largest institutions, because of an increase in deposits, are seeing on moving into the next category in terms of the G–SIB surcharge.

You said in response to Senator Rounds' question, "We are not hearing from the large firms that changes in their balance sheet over the period of the COVID event might lead them to being pushed up into a higher bucket." I just wanted to confirm to you that I certainly am hearing from those institutions that this will be a challenge. They are certainly telling their investors that this will be a challenge. Recently, JPMorgan's CFO said, "In the absence of rate calibration, which we remain hopeful about, managing that back down—she means back down to a lower category G–SIB surcharge—will certainly be challenging."

It's certainly something that she is already thinking about, and something that JPMorgan is already planning on. And I recognize that you have sufficient time to still make news on this next year, but many of those capital allocation decisions are already being made. I and every other Republican member on this committee also sent a letter a couple of weeks ago asking about this same thing.

I just wanted to confirm to you and hear your confirmation that this is an important issue. This is something that you are hearing about that I am hearing about that others or the Fed are hearing about and will at least begin to think about.

Mr. QUARLES. Yes. Absolutely. My reference to Senator Rounds' to apple of buckets as opposed to the G–SIB surcharge buckets. And as I explained, there is a—we have a year timeframe in which to see what the consequences are.

You are absolutely right that if banks aren't sure whether—what accommodations will be made or how they see their balance sheets evolving organically, that they will need to take steps well before a year from now in order to manage their G–SIB position. But we do have time to think that question through because of the way the G–SIB framework is structured.

Mr. HOLLINGSWORTH. I understand. And certainly, I don't want you to not think it through. Please don't think I am a proponent of that. But I just want to make sure that it is being thought about and that we all recognize collectively that this is a real issue, and it is going to start having meaningful impacts on our large institutions even earlier than a year from now.

Mr. QUARLES. Absolutely. Unquestionably.

Mr. HOLLINGSWORTH. Perfect. Wonderful.

To you, Chair McWilliams, I wanted to ask about your FDIC rule modernizing the regulatory framework for broker deposits. You said, I think earlier today or perhaps yesterday, that this should be finalized before the end of the year. Is that correct?

Ms. MCWILLIAMS. That is correct.

Mr. HOLLINGSWORTH. Wonderful. I know I sent a letter, along with many others, about how we can work through the facilitating portion of that rule. I know that I expressed some real concern that the restrictive nature of how you thus far had defined, "facilitating" might lead to an adverse impact on some of our community banks.

As a part of finalizing that role before the end of the year, do you expect there to be changes to the facilitating definition, enabling our community banks to use third-party servicers for some of their critical technology and infrastructure?

Ms. MCWILLIAMS. I can't engage in the specifics of what the final rule will look like, but I can certainly tell you that the reason we have the notice in common process is to solicit the type of feedback that you and others have provided so that we can improve the rule-making before it becomes finalized.

Mr. HOLLINGSWORTH. Wonderful. I certainly appreciate that. I certainly understand that. Please know that from my perspective, and so many of the community institutions all the way across our districts and all the way across the country, this is something that really concerns them. They utilize these third-party vendors to enable them to compete with larger institutions that have that technology, have those capabilities in-house. They don't want to see themselves be deprived of those infrastructure pieces so that they can compete for consumer attention, for consumer deposits, for more opportunities for them and their consumers. So please know, at least from our standpoint, that is an important thing to tweak.

And with that, Mr. Chairman, I yield back.

Mr. GREEN. Thank you. The gentleman yields back.

Ms. Tlaib is now recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Mr. Chairman, and thank you all so much for being with us.

I know in the financial stability report released this week, the Board had acknowledged that climate change is a financial stability risk. I represent Wayne County, which has one of the poorest air qualities in Michigan, and hasn't met the Clean Air Act standards in over a decade, so I do want to talk specifically about Marathon Petroleum Refinery, which is in my district. They have repeatedly had a number of violations recognized by the State of Michigan, and the residents who live near that refinery continue to have a number of concerns and issues that they bring to my office almost daily.

Marathon bonds are also owned right now by the Fed, basically the public, $15 million worth of bonds that we own right now. And you all know I wrote a letter to the Board where I highlighted how long [inaudible] Marathon nearly 20 percent of the Fed's secondary market Corporate Credit Facility portfolio is bonded—is bonds from the energy—for the energy and utility companies.

So, I would like to ask Vice Chair Quarles, what do I tell my constituents about this? When they see this and they see the various headlines, when they find out that the public's resources and our money and the risk on us, it is not investment into State and local governments but instead, invested in the very companies that are in their communities, that are responsible for bad air quality in their community?

Mr. QUARLES. Thank you for that. The Federal Reserve Facilities—we do have a Facility for State and local governments that has been serving a useful market support function—

Ms. TLAIB. But how many cities have benefited from [inaudible]?

Mr. QUARLES. I am getting that information now, because I want to respond precisely. Three issues that—the MLF about three issues, but its principal function is to restore the capacity of private markets, and many markets have healed across-the-board. But for those Facilities to do their job, we at the Fed can't be involved in credit allocation. We establish broad parameters, and the allocated decisions as opposed to the market support decisions are really for Congress.

Ms. TLAIB. I do want to get very centered on—the report came from you, the Financial Stability Report that acknowledges the risk of climate change, how it poses a financial—kind of, it poses instability in our economy. What are the Board's plans to change the Corporate Credit Facility's account of those risks? Are we just ignoring them? And I still want an answer as to how many cities you all helped through the MLF program?

Mr. QUARLES. There were three purchases. I said that. But the new Facility operates mostly through its effect on the broad market, and the broad market has healed substantially. So with respect to climate, we are looking at that from a broad systemic point of view as opposed to specific purchases.

Ms. TLAIB. Doesn't holding these millions of dollars in bonds in Marathon Refinery create instability? It is like you are trying to create stability, but your own report says climate change is posing financial instability. Then, why aren't we just basically saying, "Hey, we are going to move away from this, and maybe focus on local and State Governments?"

Mr. QUARLES. No, that was not the conclusion of the report at all that we should—

Ms. TLAIB. What was it saying? Wasn't it saying that there is a climate change issue?

Mr. QUARLES. I do think that there is a climate change issue, but we have certainly not concluded that the mechanism to address climate change is credit allocation. That should not come from the Federal Reserve. If there is a credit allocation decision to be made, that is a decision for Congress, to be debated by the public's representatives.

Ms. TLAIB. Yes, I agree. I understand. And I am working on that, as you probably know.

Why aren't we helping local and State Governments more? It sounds like we only helped one or two States. What cities have benefited from the MLF program so far? We are in a pandemic. They were in survivor mode prior to this pandemic. They literally are the frontline communities, Vice Chair Quarles—literally, the frontline communities that are stopping the spread of COVID, and you don't even know how many cities have been helped.

Mr. GREEN. [presiding]. The gentlelady's time has expired. We will accept the answer in the record.

Mr. QUARLES. Thank you.

Mr. GREEN. I am advised by the chairwoman to announce that we have a hard stop at 3:30, and that I am to get to as many Members as possible between now and 3:30. With that said, the gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman.

And thank you to our panel for being here.

I want to start my questions with Mr. Quarles, and go back to the Secured Overnight Financing Rate (SOFR) conversation a bit and try to put some fine points on some of your earlier comments. First question, how has SOFR stood up from a stability and suitability standpoint during the pandemic?

Mr. QUARLES. Our experience with SOFR during the pandemic is that as a reference rate, it has stood up quite well.

Mr. GONZALEZ OF OHIO. Great. And then just a more direct question: At this point, is there any reason to believe that SOFR would not be a suitable replacement for LIBOR, going forward?

Mr. QUARLES. No, particularly for capital markets and derivatives transactions, which are the bulk of the transactions that use LIBOR as a preference rate.

Mr. GONZALEZ OF OHIO. Great. And then, could you clarify what you meant when you said earlier that the plan is to allow existing contracts to mature on the LIBOR rate without needing a congressional solution, given that so many of the contracts would, in fact, expire after LIBOR would go away? Could you just kind of clarify that one for us?

Mr. QUARLES. Yes. The issue that we have had is that extensions of LIBOR, which there have been a couple of over the course of the last decade, after it became clear that it would be going away, results in the writing of new contracts, so, the problem just perpetuates itself.

I think that the best solution would be a framework in which we allow the existing contracts—we create an environment in which the existing contracts could mature on their current basis without renegotiation, without change to a different rate, but that new contracts would not be written. And over a relatively short period of time, the bulk of existing contracts would run off. These are not usually long-term contracts.

There is a hard tail of contracts that would require a longer time, and legislation could be useful to help with those. I think once it became clearer what the nature of that hard tail was, and we had more time to think it through, therefore, potential legislative responses, that the combination of some mechanism to allow the bulk of the existing contracts to mature with time over the course of the next year, year and a half, to think about the legislative solution for those that won't would be the best approach.

Mr. GONZALEZ OF OHIO. Thanks. And then with respect to that hard tail, how soon would you suspect we would need to act, congressionally or otherwise, before we would start to see implications in the broader economy, in the real economy?

Mr. QUARLES. Sorry. I think we are still working through that issue currently. It is not a long time. I think probably a year, or a year-and-a-half. This is something that we should be engaged with the folks who are concerned [inaudible].

Mr. GONZALEZ OF OHIO. I hope to work with you and your office on that. I personally think we need to act a bit sooner than a year and a half, but I am sure we can hammer that out.

I want to shift now to Chair McWilliams. One of the things we have talked about is the difficulty of MDIs and community banks in adopting technology. This year, the FDIC issued a Request for Information (RFI) for public input on the idea of fostering the creation of a public/private standard-setting organization for technology vendors and models seeking to work with community banks.

The idea is that small banks need to be able to adopt the technology developed by third parties, but those organizations need to meet standards to be sure tools are effective, secure, and compliant. Can you just talk a bit in my last minute about what your vision for this program is, what problems you are trying to solve, and how this will make our community banks more competitive?

Ms. MCWILLIAMS. Sure. And you have a minute, so I am going to get all of this in, in a minute. I realized early in my tenure that one of the elements for survivability of community banks will be to engage with third-party source providers, primarily fintechs and technology companies, that can help them deliver better products, more products, and reach more customers, especially in rural areas as discussed earlier in the hearing.

And I reached out to several Silicon Valley firms. I went and I met with them, technology firms, and to partner with banks, and I asked them, "What can be done to help you partner up with these banks more quickly?" We don't regulate these firms. And fintechs, budget, through the third-party service arrangements, were able to provide this feedback to us.

And they said that in the beginning, when they approach a bank, to be on-boarded with a bank, they have to go through the same due diligence process with each and every bank. So we said, why don't we kind of cut out that process and make it very simple where they get certified to this public/private partnership, and then use that certification to ease the burden on the banks, and use the burden on the fintechs when they partner up.

Mr. GONZALEZ OF OHIO. I think that is a fantastic idea. I yield back.

Mr. GREEN. The gentleman's time has expired. The Chair now recognizes Ms. Porter.

Not hearing from Ms. Porter, I will now recognize Ms. Wexton.

Ms. WEXTON. Thank you, Mr. Chairman. And thank you to the witnesses for appearing today.

I want to switch gears and talk a little bit about something that I kind of see as a potential ticking time bomb in our financial system, and that is the commercial real estate market. Chairwoman McWilliams, there has been a rapid growth in CRA exposure, especially for smaller banks. Is that correct?

Ms. MCWILLIAMS. They have had high concentrations in CRA portfolios, and it was one of the primary concerns we had in the last crisis as well.

Ms. WEXTON. And currently, the FDIC considers at least 356 banks as concentrated in the commercial real estate bank market. Is that correct?

Ms. MCWILLIAMS. That number sounds right. I don't know how—it may be slightly outdated.

Ms. WEXTON. So what do you mean by, "concentrated?"

Ms. MCWILLIAMS. The majority of their portfolio, or a very large number of their portfolio—we don't have a magic number. We don't tell them it is X percentage has exposure and is heavily concentrated in the CRA market.

Ms. WEXTON. But that means that by, "concentrated," you mean that they are exceeding the FDIC's regulatory criteria or your recommended proportion of a portfolio being made up of commercial real estate portfolios?

Ms. MCWILLIAMS. We don't have a clear-cut number, where—it depends on the individual institution, and we are trying not to manage our institutions with that kind of a blunt-cut instrument by telling them it is X percentage. But we will look at each individual institution, look at their risk management profile, capital levels, their CAMEL ratings, management experience, do they know how to manage this, did they go through the last crisis with these issues as well and how did they fare?

So I would say we have more of an individual ad hoc bespoke, if you like, approach to how we look at commercial real estate exposures at individual community banks.

Ms. WEXTON. But it is fair to say that these are institutions that are more likely to fail if we see commercial loans go bad in large numbers. Is that correct?

Ms. MCWILLIAMS. I would say that it would be one of the factors that could lead to their failure if it is not managed appropriately and the management doesn't have experience in how to deal with it.

Ms. WEXTON. What are some of the indicators or warning signs that we are seeing now in the commercial real estate sector that give you pause for concern in the FDIC?

Ms. MCWILLIAMS. We are certainly looking at a number of buildings. And there was just an article this morning that folks are subletting their leases. They are realizing they don't need the high level of occupancy in the square footage that they have seen in the past. And so, we are working with our banks to make sure they understand what the exposure is.

This is not a—kind of a snapshot-in-time exposure. Most of these leases are multi-year, in some case, multi-decade leases. And we want to make sure that small banks, in particular, have the ability to manage those portfolios, are working proactively with their borrowers, they understand where the companies that own these buildings are in their economic cycle, and also reaching out to both regulators, us, and their examiners to charge if they foresee any issues.

Ms. WEXTON. But these losses are slow to materialize because of the duration of those loans and everything else? For example—

Ms. MCWILLIAMS. I'm sorry. The first part of the—

Ms. WEXTON. —and they didn't peak until 3 years after the 2009 recession. Is that correct?

Ms. MCWILLIAMS. I'm sorry, the question—it broke up in the first part of the question. Can you repeat it, please?

Ms. WEXTON. I was just saying that it takes a while for these losses to materialize because of the duration of the loans.

Ms. MCWILLIAMS. It generally does, yes.

Ms. WEXTON. Right. But the fallout when these loans go bad won't just be contained to the banking sector, because—can you talk a little bit about the exposure to pension funds and others and what that will mean?

Ms. MCWILLIAMS. Sure, and it truly is an ecosystem. The reason that some of those folks who are renting commercial space are unable to make their payments is because the commercial activity has subsided, which is generally a sign of the economic downturn. And so, that is something we have tried frankly to prevent with some of the actions we have taken over the past few months.

Certainly, the ecosystem doesn't stop with the borrower and the lender. There are investors in the banks that have exposure here as well. To the extent that these commercial real estate loans get securitized, we have exposure in the secondary market, as you mentioned. So it is not a simple formula whether it is—

Ms. WEXTON. I am running out of time, and so I just would ask, other than banks increasing their reserves to absorb loan losses, what else should we be doing to head off this situation? Is there anything else that you would recommend?

Ms. MCWILLIAMS. I can tell you from our perspective, we are working with individual banks that have high concentrations in the affected industries, including commercial real estate throughout the country. I can't think of any recommendations right off the bat. If we exhaust our regulatory discretion in how we can address and work with these, I will certainly let you know. But the best thing we could do is—

Ms. WEXTON. In my last 15 seconds—I am sorry to interrupt you, but do you think that you have the authority to extend the troubled debt restructuring theory beyond 6 months as a regulatory matter of course, or do you need statutory authorization to do that?

Ms. MCWILLIAMS. There are two different TDRs: one in the CARES Act: and the other is our personal individual FASB to take concurrent by FASB to do so for us.

Mr. GREEN. The gentlelady's time has expired. The Chair now recognizes Ms. Porter for 5 minutes.

Ms. PORTER. Thank you.

Mr. Quarles, the Fed is largely responsible for dispensing the $500 billion in taxpayer money that Congress provided as a bailout for corporate America, the biggest bailout in our country's history, potentially. Using taxpayer dollars to buy bank debt was never part of that plan. In fact, the Federal Reserve stated, explicitly in this document, that it would not be purchasing bank debt. What happened?

Mr. QUARLES. I couldn't quite tell. I am on the grid, but I couldn't quite see what the document was, so I am not quite sure what document you are referring to.

Ms. PORTER. It was the Federal Reserve's own rules regarding the frequently asked questions for the Primary Market Corporate Credit Facility. And what it says, in fact, is that—what bonds will be included. And it says, those that are issued by an issuer that is not an insured depository institution holding company or subsidiary of a depository holding company, in other words, a bank. So, the Secondary Market Liquidity Facility—

Mr. QUARLES. Yes.

Ms. PORTER. The Corporate Credit Facility and the Secondary Market Corporate Credit Facility said they weren't going to be buying bank debt. That is in the FAQs, which I am going to put into the record, so what happened then? Why are you buying—why is the Fed bailing out the big banks?

Mr. QUARLES. Yes. I understand the question now. No, we haven't bought bank debt in those Facilities. To begin the—

Ms. PORTER. Mr. Quarles, reclaiming my time, has the Fed, as part of a coronavirus bailout, purchased bank debt, yes or no?

Mr. QUARLES. No. We have purchased—

Ms. PORTER. Okay. What is an exchange-traded fund (ETF), Mr. Quarles?

Mr. QUARLES. As I was getting ready to say, we have purchased exchange-traded funds at the very beginning of the process in order to jump-start the reignition of the economy, and we stopped purchasing exchange-traded funds several months ago.

Ms. PORTER. Exchange-traded funds, for everyone who is watching, are just baskets basically of stocks issued by a variety of companies. And is it not correct that the Fed bought $1.3 billion in ETFs?

Mr. QUARLES. That number sounds right.

Ms. PORTER. Okay. So, this is our—

Mr. QUARLES. But that is not $1.3 billion of bank debt.

Ms. PORTER. Okay. No, so it is $1.3 billion in exchange-traded funds. And my question for you is, how much of that was bank debt in those exchange-traded funds?

Mr. QUARLES. Yes. I can get that information for you. I don't have the numbers in front of me.

Ms. PORTER. Well, it was a lot, right? The bank money that is in these exchange-traded funds, this is companies like JPMorgan Chase. Their debt is in there. And it is a big problem that you did this.

A White Paper published by the Yale School of Management showed that, in fact, 15 percent of all that ETF purchased was for big banks, and ultimately, to the tune of more than $2 billion in taxpayer money.

Mr. QUARLES. I am not—

Ms. PORTER. This is a headline from Bloomberg, "Despite Stated Exclusion, the Fed Is Buying Bank Debt." Would you like to revise your statement about—your earlier answer when I asked you whether or not the Fed had purchased bank debt as part of coronavirus relief?

Mr. QUARLES. No. That answer was entirely accurate. We have not purchased bank debt. We purchased ETFs. Those ETFs—

Ms. PORTER. Do those ETFs contain bank debt?

Mr. QUARLES. The ETFs contain a portion of bank debt. We stopped buying the ETFs several months ago. It was important to buy the ETFs in order to jump-start the general process of restoring the economy, which has benefited everyone.

Ms. PORTER. So, what happened here is you said you wouldn't buy bank debt. Then, you crafted a loophole using ETFs so the Fed could buy bank debt, a loophole buried in a subparagraph of rules on the Fed's website, and this loophole essentially swallowed up $2 billion in taxpayer money during COVID to bail out big banks, even as you told the public that the money could not go to any bank?

Mr. QUARLES. We did not purchase any bank debt. If we had not purchased the ETFs, we would have had a credit market implosion that would have been devastating to the economy. No one would have wanted that. As soon as that was no longer necessary, we stopped purchasing ETFs.

Ms. PORTER. Reclaiming my time, who is the world's largest issuer of ETFs?

Mr. QUARLES. I don't know, off the top of my head.

Ms. PORTER. BlackRock.

Mr. QUARLES. Probably BlackRock.

Ms. PORTER. BlackRock, yes. I think you do know that. BlackRock. Who is Larry Fink?

Mr. QUARLES. Larry Fink is the CEO of BlackRock.

Ms. PORTER. Did the Fed hire Larry Fink and BlackRock to advise it—and this seems beyond belief to me—to buy BlackRock's own ETF products?

Mr. QUARLES. I'm sorry, the alarm had gone off.

Mr. GREEN. The gentlewoman's time has expired. The answer may be submitted for the record.

Mr. QUARLES. Thank you.

Ms. PORTER. Mr. Chairman, may I submit these documents for the record?

Mr. GREEN. Without objection, it is so ordered.

Ms. PORTER. Thank you.

Mr. GREEN. Mr. Rose is now recognized for 5 minutes.

Mr. ROSE. Thank you, Chairwoman Waters and Ranking Member McHenry, and thank you to our witnesses for being here today. Like many of my colleagues, I also want to thank you for the great work done by our regulators throughout this pandemic response. Your swift efforts to accommodate regulatory and supervisory policies were extremely important, and moving forward, I urge you to continue to be flexible to ensure a strong economic recovery.

Nearly 60 percent of the automated teller machines in the United States are independent, nonbank terminals. It is those ATMs that are typically found in low-income communities and thinly-populated rural areas in which there are few, if any, bank offices or bank-owned ATMs.

The widespread closures and denials of bank accounts to businesses within the independent nonbank ATM industry present a serious threat to the financial stability, not only of consumers who live in the area served almost exclusively by independent nonbank ATMs, but also the tens of thousands of retail and service businesses serving these consumers on a daily basis.

In a Financial Services hearing on February 15, 2018, the National ATM Council's Tim Baxter testified about the, "widespread and severe consequences that in, recent years, have resulted from financial institutions' practice of de-risking," and I might add, the prejudicial treatment that was a direct result of Federal regulators' implementation of Operation Choke Point in 2013.

He noted that it is impossible for ATM operators to do business without having a bank account. But even with the end of the Operation Choke Point initiative, independent ATM providers were increasingly being notified by their banks, without explanation, that their deposit accounts were to be closed, or, in some cases, already had been closed.

My question for you, Chairman McWilliams, Vice Chair Quarles, and Acting Comptroller Brooks, is, could each of you describe what the regulators are doing to address the fallout, the ongoing fallout from Operation Choke Point and its effect on ATM owners and the operators who are still having their accounts closed? Chair McWilliams, you may begin.

Ms. MCWILLIAMS. Sure. And I suspected the question was coming my way, so I reached out for the pronouncements we have issued in the past. Certainly, we have made, I would say, very concentrated and concerted efforts to make sure that our institutions understand and offer services to the businesses in their communities, including businesses that might have been ostracized in the past by so-called Operation Choke Point.

I have a statement I issued in November of 2018 telling our colleagues at the FDIC to make sure that when we examine banks, we were clear in our communication. We have resolved a lawsuit that was pending against the FDIC in connection with Operation Choke Point, even though that operation wasn't necessarily named Operation Choke Point by the FDIC.

But in any case, we have issued a statement basically saying that financial institutions should have the ability to assess the risk profile of individual clients, and do so in accordance with their risk appetite and management practices.

And then, we have a statement that we issued in 2015, basically saying that the FDIC encourages institutions to take a risk-based approach in assessing individual customer relationships, rather than declining to provide banking services to entire categories of customers without regard to the risks presented by an individual customer or the bank's ability to manage the risk.

I don't know what else to say, to tell you the truth, to make sure that it resonates down to individual institution's level that they should not shut out the entire industry, or the entire type of business, but that they should manage that risk based on their risk appetite and management's experience in handling the type of risk that they may be concerned about.

Mr. ROSE. Thank you, Chair McWilliams.

And I see our time is about to expire. I recently led a bipartisan letter to the three of you, Chair McWilliams, Vice Chair Quarles, and Comptroller Brooks, and I would just encourage you, the three of you, to respond to that in a timely manner.

And thank you for your answer, Chair McWilliams.

And with that, I yield back the balance of my time. Thank you.

Mr. GREEN. The gentleman's time has expired. Mr. Taylor is now recognized for 5 minutes.

Mr. TAYLOR. Thank you, Mr. Chairman. I appreciate this hearing. I think this is important.

I wanted to dig down on forbearance with our banking institutions. I recall the March 13th guidance that came out about forbearance for banks. This question, by the way, Mr. Brooks, is for you in your capacity as Acting Comptroller of the OCC. My question is, at what point are you going to start telling banks you have forbeared long enough, it is time that you start looking at foreclosure for assets?

This borrower cannot pay. How are you thinking about the end of forbearance? And I will say that forbearance is extremely important. We have seen real trouble in the commercial real estate space, building on what Ms. Wexton was talking about earlier, where you have CMBS loans that don't have a forbearance mechanism in them that the OCC has been able to guide for banks.

So, that has made banks much more flexible as a credit facility, but at some point, that flexibility ends. Where do you think it will end, Mr. Brooks?

Mr. BROOKS. Congressman, that is a great and really important point. I would start by saying, one of the lessons we learned in the financial crisis is that two things in a downturn like this are equally important: one is making sure that you provide loss mitigation guidance and forbearance for everybody during a crisis; and the other is unwinding all of that as soon as the crisis abates.

And the reason I say that is so important is that the data in the financial crisis shows that those States that extended long eviction moratoriums and long foreclosure prevention programs long after the immediate crisis was there had the most sustained real estate downturns, the longest term unemployment, and the most sustained sort of decline in overall real estate prices relative to States that came back to normal faster.

So our basic view is it was appropriate to put forbearance programs in place right away, as soon as the pandemic was recognized as a crisis, but it will be equally important to go back to normal with not one moment to spare, lest we repeat the mistakes of kind of the 2012, 2013, 2014 era post-financial crisis.

And so, the way we look at things is basically this: First of all, banks learned in the financial crisis that it is in their interest to make net present value positive loan modifications. They get that. And every CEO I talk about is fully aware of the fact that anybody who reasonably can repay should be kept in the loan or kept in the property until such point as they are able to start doing that.

There will come a time, almost certainly, where there will be some amount of long-term permanent economic damage here. And in those circumstances, we are not doing anybody a favor by pretending like those assets are still assets on the balance sheet of a property.

The reason that mortgages and secured loans are a lot cheaper than credit card loans and unsecured loans, obviously, is because they are secured by collateral, and at a certain point the safety and soundness of the system requires that execution against the collateral occur.

I don't think we are there yet. It is very clear that at this point, we are still in the midst of the late stages of the pandemic, but I would be surprised if in one or two quarters, given the vaccine, the therapeutics, and the economic upturn, that at some point, the data will suggest that a return to normal is required, and at that point, we are going to need to go back to normal treatment of collateral.

Mr. TAYLOR. Okay. That is helpful. So you are sort of saying one to two quarters. And then are you—as you go and do your inspections with banks, with institutions, when it is clear to you, look, this company is in bankruptcy, or their customer base is completely gone, there is just no way they are—they are not coming back any time in the near future, are you pushing those institutions to start to foreclose and move with the collateral, or are you still saying, just keep it on your books, forbear, let's just keep your balance sheets strong or make it look strong even though it is not strong?

Mr. BROOKS. No, Congressman, I say just the opposite. One thing I have been very clear about, and I have been speaking to State bank trade associations about this twice a week for the last 6 or 8 weeks, is that we are not blaming any banks for originated good credits that went south in the pandemic. But what we are very focused on is making sure that banks are classifying loans as it becomes clear that they are not going to repay so that we can assess that risk, they can take provisions and they can prepare to do charge offs and foreclosures on the back end of that. We have been very focused on that.

Having said that, there is good news still in the system, and this picks up on a point that Vice Chair Quarles made a couple of hours ago, which is, there is still some amount of dry powder in the system from the PPP program, a series of other programs put in place. So we can still see in bank—in deposit accounts that there is enough runway, even for some small businesses that are not currently doing business to continue to make payments out of the proceeds of those loans.

That runway, obviously, will expire, and when it expires and there is no reasonable prospect of those customers going back in business, there will be foreclosures and defaults at that point. It is one of the reasons that I emphasize the need to look at—

Mr. TAYLOR. My time has expired. Thank you, Mr. Brooks. I yield back.

Mr. GREEN. The gentleman's time has expired.

And I must announce at this time that Mr. Casten will be the last person to ask questions. Mr. Casten, you are now recognized for 5 minutes.

Mr. CASTEN. Thank you, Mr. Chairman. And thank you all for being here.

As those on this committee know, I am here in Congress because I am deathly concerned about climate change. It affects every aspect of our lives, our health, our national security, and our financial system. And the effects of climate change, both physically and financially, are nonlinear, but our human brains think in linear patterns, which makes us prone to massive undershoot, which is what we have done over the last 30 years.

In that context, I was very pleased to see that the Fed finally listed climate change among risks in its biannual Financial Stability Report, and I was happy to hear that the Fed is going to join the Network for Greening the Financial System (NGFS), reversing its earlier position.

I want to start with just a quick yes or no across the panel. Do you believe that climate change poses a significant financial risk, yes or no, Vice Chair Quarles?

Mr. QUARLES. I believe that it certainly poses a risk that we need to understand. I should state that we did not reverse our position on joining the NGFS. We have always—

Mr. CASTEN. I understand.

Mr. QUARLES. —been talking with them about joining.

Mr. CASTEN. Well, participating, but were not joining. Yes or no, Chair Hood, do you believe climate change poses a significant financial risk?

Mr. HOOD. I believe it is a risk that is worth understanding more so we can get better clarity and so we can really try to mitigate it.

Mr. CASTEN. Chair McWilliams, yes or no?

Ms. MCWILLIAMS. It's a risk we have asked our banks to take into account when underwriting loans and considering risk management in general.

Mr. CASTEN. Acting Comptroller Brooks, yes or no, does it present a significant financial risk?

Mr. BROOKS. I would echo the comments of my colleagues.

Mr. CASTEN. Okay. I am a little troubled that you all seem to be hedging on the word, "significant," but moving on from there, Vice Chair Quarles, the Fed has previously said to your point that they would stay on the sidelines in the NGFS, but this week announced that you would request membership. Can you give any color on what prompted the change in approach, Vice Chair Quarles?

Mr. QUARLES. There was no change in the approach. We have been talking with the NGFS about joining them for some time. They had indicated that would not be possible until recently.

Mr. CASTEN. Okay. Well, I am glad that you joined.

About an hour ago, I was pleased that Chairman Powell, said, "We do think that central banks and we here at the Fed have a contribution to make. The focus is on incorporating climate change risk into financial stability and bank regulation." And, "It follows from our assigned legal mandates that we do this work."

Vice Chair Quarles, do you believe that we currently have enough insight into banks' climate risks to appropriately assess the overall health of the banks and the financial system as a whole?

Mr. QUARLES. I think we can always improve it, but we do have mechanisms to understand risk of the banks, including [inaudible]—

Mr. CASTEN. Do you believe that the Fed has the existing authority to stress test financial institutions for potentially systemic risks, including, but not limited to, climate change, in the absence of congressional mandate?

Mr. QUARLES. Oh, yes, but we certainly don't need a congressional mandate to do that. There is a great deal of work that would be needed to do that properly. The Bank of England is probably—has done most of the—has probably most advanced in thinking about that, and they are still very preliminary in doing that. They have had [inaudible] Their approach on stress testing for climate.

Mr. CASTEN. I don't know if there was a difference of opinion in the way that you all answered the question at the start, but let me be very clear: There is a significant risk associated with climate change. There are hundreds of billions of dollars of loss in assets.

If you were to agree with me that there is a significant risk to the financial system, do you believe you have the obligation to stress-test the financial institutions for those potentially systemic risks?

Mr. QUARLES. We will stress-test all of the risks that are modelable. We do that.

Mr. CASTEN. I hope that you can appreciate my question. We have huge amounts of loss on coastal properties, huge amounts of loss from forest fires across the country. We are going to be through the Greek alphabet pretty soon and into the Hebrew alphabet if we are not careful on the hurricanes that are hitting our shores this year. I don't know actually if the Hebrew alphabet follows the Greek alphabet; I just know that we are getting near the end of the first one.

But if what it takes is congressional direction to act, then the bill that I have been leading with Senator Schatz, the Climate Change Financial Risk Act, is necessary. But I would hope that you all are willing and able and have the obligation to do that beforehand because these risks are massive, and as I said at the start, our human brains don't do very well with nonlinear change. Albert Einstein's great line was that the most amazing thing ever invented was compound interest, and we are in a very nonlinearly changing world.

Thank you, and I yield back my time.

Mr. GREEN. The gentleman's time has expired.

On behalf of the chairwoman, I would like to thank our distinguished witnesses for their testimony today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 3:34 p.m., the hearing was adjourned.]

# A P P E N D I X

November 12, 2020

For Release Upon Delivery
12:00 p.m.
November 12, 2020

STATEMENT OF

BRIAN P. BROOKS

ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

November 12, 2020

Statement Required by 12 U.S.C. § 250:
The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

***Introduction***

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for this opportunity to appear before you today to discuss the activities underway at the Office of the Comptroller of the Currency (OCC) to ensure that the national banks and federal savings associations that we regulate operate in a safe, sound, and fair manner. Since assuming the role of Acting Comptroller of the Currency last May, I have been dedicated to promoting all facets of the OCC's mission and specifically fair access to capital and credit for the hundreds of millions of national bank customers, and ensuring the efficient flow of capital to businesses and communities across the country.

Growing up in poor, rural Colorado, I saw the good banks could do to promote growth and opportunity by making capital, credit, and services more available. I also witnessed the potential that remains unmet. Since those early observations, I have spent my entire adult life in financial services—as a lawyer in banking and finance, a banker, an executive in housing finance, a board member, and most recently an executive in financial services technology. At each step in my career, I have worked to expand access to banking and financial services so that consumers and businesses could meet their basic needs and achieve their financial goals. I am proud to contribute to the OCC's 157-year-old mission as Acting Comptroller. While serving in this capacity, I have a unique obligation to effect change for the collective good and work toward greater financial inclusion and better access and treatment of the underserved. Now more than ever, in the wake of the pandemic and the continued social unrest following the killing of George Floyd in May, regulators and banks have a responsibility to work to alleviate the inequities that exist in the system and remove barriers to access and inclusion. That is why I created Project REACh (Roundtable for Economic Access and Change) in July and will continue to convene bankers, civil rights leaders, and business magnates to identify and solve intractable problems that have prevented full and fair access for so many for far too long.

This testimony provides more detail on Project REACh and some of my other priorities, but first details the OCC's response to the coronavirus, provides an overview of the condition of the industry, and describes our recent activities to fulfill our statutory and regulatory responsibilities.

***Agency Response to COVID-19***

I joined the OCC on April 1, 2020, roughly two weeks into the nation's experience with the pandemic related to COVID-19. During the subsequent months, the OCC has worked independently and together with the other federal banking agencies to publish nearly 50 separate issuances to provide regulatory relief and guidance that have enabled the federal banking system to be a source of strength for consumers, businesses, and communities throughout the nation. I am proud of our work to provide rapid clarity and guidance that encourages the banks and savings associations (banks) we supervise so they may use their strength to meet their customers' needs during these very difficult times. National policy makers recognized the unique position and capability of banks to support the nation's pandemic response strategy as a conduit for capital, lending, and other relief. Just as banks have been a source of strength for citizens, businesses and communities during the pandemic, they will lead the national recovery as well.

Internally, the OCC has placed a priority on the health and safety of its workforce and has taken steps to safeguard its employees while maintaining their ability to continue to fulfill our important mission of ensuring the safety, soundness, and fairness of the federal banking system. While the OCC never closed its offices, we operated at a maximum telework posture from March 16 through June 21. Since then we have provided employees flexibility to work from home, and approximately 90 percent of the agency's employees have opted to do so to provide mission-critical services. As banking is one of the essential industries in this country, we recognized the importance of continuing our work uninterrupted while preserving our employees' ability to meet their families' needs and conduct their responsibilities, while observing the necessary precautions to remain safe and healthy.

We continue to support employees who face challenges with child and elder care needs by providing flexible work hours, additional leave and extended telework options. We created new options to support commuting safely for employees who were concerned with mass transit. We increased cleaning and safety protocols to meet or exceed recommendations from the Centers for Disease Control and Prevention. We limited non-essential travel, but we never ceased or suspended our supervision of the federal banking system. Managing the impact to our operations involved a great deal of complexity, coordination and flexibility assessing local needs, health and safety considerations, and potential restrictions in nearly 90 separate operating locations, including our headquarters here in Washington, D.C.

During what has been a period stress and uncertainty, we also increased the pace of our communications among executives and with staff, have been transparent about decisions, and continually promote employees' awareness of potential exposures while safeguarding employees' personal medical information.

Our communication actions included immediately setting up a web page on our intranet for employees to check regularly on issues relating to COVID-19 that affect them. We also established calls multiple times per week for executives to coordinate COVID specific issues and hosted frequent town hall calls for all 3,500 employees to hear directly from agency senior leaders and ask questions of them. Today, we continue to hold executive and town hall calls with all employees monthly.

The agency will continue to assess its operating posture and consult available information but plans to operate in an extended telework capacity until facts and circumstances change to support more normal operations.

***Agency Support to Banks and Customers in Response to COVID-19***

Since the pandemic began, the OCC, often with other regulatory counterparts, has published nearly 50 separate issuances including bulletins, statements, press releases, and interim final rules to provide timely information to our examiners and the banking industry. The topics of issuances ranged from encouraging financial institutions to work constructively with borrowers and other customers affected by the pandemic to issuing rules to implement the provisions required by the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Several issuances were intended to alleviate regulatory burden during the pandemic, and the OCC also reduced assessments for our regulated institutions affected by the national emergency so they can focus on assisting customers. Every issuance is listed in Appendix 1 and accessible on the OCC's website under our COVID-19 heading.[1]

The OCC will continue to monitor the consumer and economic effects of the COVID-19 pandemic and will not hesitate to take additional action as necessary to help the federal banking system maintain its role as a source of strength for the country as it manages its response to and recovery from the pandemic.

***Condition of the Banking System and OCC Market Monitoring Efforts***

The OCC supervises nearly 1,200 national banks, federal savings associations, and federal branches and agencies of foreign banks (banks) operating in the United States. These banks range in size and complexity from small community banks to the largest most globally active banks. The vast majority of national banks and federal savings associations, numbering nearly 900, have less than $1 billion in assets, while 62 have more than $10 billion in assets. Combined, these banks

[1] See http://occ.gov/covid-19.

hold $14.1 trillion or 68 percent of all assets of U.S. commercial banks.[2]

OCC-supervised institutions also manage nearly $60 trillion in assets held in custody or under fiduciary control, which amounts to 44 percent of all fiduciary and custodial assets in insured U.S. banks, savings associations, and uninsured national trust banks.[3] The federal banking system holds more than three-quarters of the credit card balances in the country, while servicing almost a third of all first-lien residential mortgages. Through their products and services, most American families have at least one relationship with an OCC-regulated bank.

In late February, the OCC implemented enhanced market and credit monitoring activities that continue today. This effort ensures that we are aware of, and give prompt attention to, any potential adverse effects on individual banks and the federal banking system resulting from the pandemic and allows us to analyze current trends and to provide appropriate regulatory assistance to institutions as warranted.

Overall, banks in the federal banking system remain in strong condition with sound capital and liquidity levels, but we are paying close attention to several indicators of health. Credit risks are increasing as the economic downturn affects customers' ability to service their debts. Strategic risk is emerging because of the impact on bank profitability that historically low interest rates and potential credit stress have. Telework is affecting office space outlooks within commercial real estate portfolios. Operational risk is elevated because of the increasingly complex operating environment that includes cybersecurity, fraud, and telework challenges. Compliance risk also is elevated because of a combination of altered work environments, and the requirement to quickly operationalize new federal, state, and proprietary programs designed to support consumers and businesses.

The condition of the federal banking system prior to the COVID-19 pandemic and related containment measures was strong with ample capital, liquidity and sound credit quality. Today, bank capital levels still remain well above regulatory minimums. The tier 1 leverage ratio has declined from 9.2 percent at the end of 2019 to 8.4 percent as of June 2020, partly caused by the growth in assets related to CARES Act and other monetary support programs. However, the leverage ratio remains well above the 6.8 percent level in December 2008. Further, median CET1 Capital Ratio for large banks increased from 13 percent in the first quarter of 2014 to 14.2 percent at the end of the second quarter of 2020 and the quality of banks' capital has improved since the

[2] Data current as of June 30, 2020.
[3] Data current as of June 30, 2020.

Great Recession.

Earnings, however, face headwinds. Bank profitability will be challenged by low interest rates, provision expenses, and increasing operating costs. Net interest income fell 5.3 percent from the end of June 2019 while non-interest expenses increased 6.5 percent. Provision expenses increased because of the impact of strategies and actions taken to contain the pandemic. Net interest margins are at 30 year low.

The industry's strength ensured that the federal banking system was well equipped to carry out the range of congressional policies advanced pursuant to the CARES Act passed on March 27, 2020. The federal banking system has been the primary delivery mechanism to carry out the federal economic response to the virus, and to support programs such as the Paycheck Protection Program (PPP), the foreclosure relief programs, and the lending facilities established by the Federal Reserve Board (FRB). The banks supervised by the OCC have provided considerable relief to individual consumers, businesses and communities by serving as an important mechanism for citizens to receive their federal stimulus payments, providing new loans to small businesses to ensure they continue to keep employees on their payroll, and working with borrowers to provide mortgage and other credit forbearance programs.

Going forward, with large sectors of the economy remaining dormant, the current downturn will likely challenge some banks within the federal banking system. We expect that bank earnings will experience stress as interest rates decline and banks continue to increase provisions for expected loan losses. We are beginning to see stress on consumer and commercial borrowers because of the sharp drop in economic activity that may affect earnings and potential capital at some banks. We encourage banks to work with their borrowers as individual circumstances warrant. We also will continue to be creative and proactive to promote the health of the institutions we supervise throughout this public health emergency and to ensure the federal banking system remains a source of strength for the national economy, capable of serving consumers, businesses, and communities across the nation. The full effect on the economy and banking industry will depend on the depth and duration of the current downturn. We have seen some green shoots and have reason for optimism but will continue to watch commercial real estate, small business lending, and housing closely.

The impact of CARES Act programs on the business of banks, particularly smaller banks, was profound. Commercial and Industrial loans, driven by PPP lending, expanded about 40 percent for small banks in a span of six months ending in August.[4] Banks prudently have increased provisions in areas with greater shares of higher risk industries, such as agriculture, oil and gas, and industries most reliant on interpersonal customer interactions such as leisure and hospitality, retail trade, transportation, and industries with high unemployment risk. While too early to determine the magnitude of the risk, the consensus is that these industries will see increases in nonperforming loans and additional stress in coming months.

***Origin and Scope of Project REACh***

Since becoming Acting Comptroller, I have sought to increase fair access to banking and financial services and products and promote economic growth and prosperity for consumers, businesses, and communities, including LMI communities, across the country. Shortly after the killing of George Floyd and the emergence of a nationwide social justice movement, I recognized that the federal banking system can play a valuable and constructive role in reaching many of our citizens who have been left out or unable to fully participate in a financial system that has benefited others for far too long. Rather than deny or ignore the existence of structural barriers that make it difficult or impossible for many minority or underserved individuals to participate equally in the nation's great economy, regulators have a responsibility to seek out such barriers and work to eliminate them.

Barriers may exist for many reasons. They may be vestiges of long discredited beliefs or policies, or they may be the unintentional consequence of industry or regulatory practices intended to address other weaknesses or harms in the system. A good example involves credit scores. Credit scores were created to support safe and sound underwriting and to speed the flow of credit. They have served that purpose well. But, calculating traditional credit scores relies on certain formulas and data. As a result, there are approximately 45 million people in this country with no usable credit score[5] because activities in their lives have not accumulated certain data required to calculate a traditional credit score, despite paying rent, utility bills, and other recurring obligations.

With no credit score, these individuals are essentially shut out of the mainstream financial system. Where they can find financial services and products, they often pay much higher rates and face much more unfavorable terms. The absence of credit scores is a barrier that can be dramatically reduced, and as a regulator, I recognized the agency's unique position to facilitate

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[4] Haver H.8 data through Wednesday, August 26, 2020.
[5] Ann Carns. "Little Credit History? Lenders Are Taking a New Look at You." *New York Times*. February 24, 2017 (https://www.nytimes.com/2017/02/24/your-money/26money-adviser-credit-scores.html).

work to address this and other barriers.

To support that effort, I founded Project REACh in July 2020[6] to bring together heads of banking, civil rights, technology, and business organizations to identify and reduce specific barriers that prevent full, equal, and fair participation in the nation's economy. Project REACh convenes people with the ability to help reduce inherent policy and structural obstacles so underserved populations may have the same opportunities to succeed and benefit from the nation's financial system as others.

We have the ability to dramatically expand access to a financial system that provides economic opportunity to hundreds of millions of people.

The project involves three primary national work streams:

- **Inclusion for credit invisibles**: Forty-five million Americans—disproportionately including poor and minority Americans—lack a credit score and cannot obtain mortgages, credit cards, or other lending products. Yet many people in this segment of society pay rent, utilities, and other recurring financial obligations. Project REACh intends to work with technology partners to synthesize a credit score from alternative data, and the OCC could validate such a score for banks to use. This will help tear down a major barrier to economic access for millions.
- **Revitalization of Minority Depository Institutions** (MDIs): The number of MDIs has declined over the years. The remaining MDIs are critical sources of credit and financial services in their largely minority communities. Project REACh intends to explore partnerships among MDIs and other banks to provide a stable source of capital and investment and provide training, exchange programs, and mentorship opportunities to MDI executives and board members.
- **Increase inventory and accessibility of affordable housing:** A recent analysis of home mortgage data found the ability to access credit and obtain a mortgage is significantly more challenging for minority borrowers who do not have enough saved for a down payment. Project REACh intends to work with financial institutions and major civil rights and community-based organizations to develop down payment products that provide a bridge to obtaining the American dream of owning a home.

In addition to these national projects, Project REACh includes regional and local projects

[6] "OCC Announces Project REACh to Promote Greater Access to Capital and Credit for Underserved Populations" News Release 2020-89. July 10, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-89.html).

that focus on developing regional solutions to reduce barriers to economic access for minority communities. On October 30, Project REACh kicked off regional efforts in Los Angeles.[7] Affordable homeownership opportunities or investments in minority business enterprises to support start-up and scale-up capacity with lower collateral requirements are examples of local- and regional-specific solutions. These initiatives illustrate how banks could increase economic access for LMI communities.

Recently, several institutions participating in Project REACh launched area-specific initiatives that focus on discrete and unique challenges impacting underserved communities. One of these local projects is the expansion of a down payment assistance program offered by a participating financial institution in the Minneapolis, Twin Cities area last month. Another participating bank has structured a loan participation initiative with MDIs that would lower the cost of small business loans through a blended interest rate. We are encouraged by these examples of Project REACh participants working to translate ideas into deliverables.

The project includes contributions by the president of both the NAACP[8] and the National Urban League,[9] as well as engagement by NBA Hall of Famer Shaquille O'Neal.[10] In addition to the project's collective efforts, banks and other companies and organizations are pursuing independent initiatives consistent with the principles and spirit of Project REACh—to increase financial access by removing barriers. I am very proud of Project REACh and the impact it can have. I look forward to continuing to lead this effort.[11]

***Strengthening and Modernizing Community Reinvestment Act Regulations***

On May 20, 2020, the OCC finalized its rule strengthening and modernizing the

[7] Brendan Pedersen. "OCC announces initiative to expand credit access in Los Angeles." *American Banker*. October 30, 2020 (https://www.americanbanker.com/news/occ-announces-initiative-to-expand-credit-access-in-los-angeles).
[8] President of the NAACP Derrick Johnson commented, "The NAACP is pleased to participate in this unprecedented collaboration of public, private, and non-profit institutions committed to building bridges to economic opportunities for African-Americans and closing the ever-widening wealth gap in this country; and we look forward to working collaboratively on solutions addressing systemic and institutionalized economic discrimination that has existed for decades."
[9] National Urban League President Marc Morial said, "With Black homeownership, median household wealth, and access to capital sinking like a stone, we need to get serious about dismantling the systems that keep Black and other underserved communities locked out of the American Dream. REACh represents the kind of initiative that invites the right people to the table. It contains features that can help break barriers to accessing capital and has the potential to help Black families accumulate wealth to reverse this drive to negative household wealth. If implemented in good faith and with sustained effort, REACh can be an important piece of the puzzle. We commend the OCC's efforts to lean into solutions to the unprecedented economic loss caused by this pandemic."
[10] See CNBC interview of September 9, 2020 at https://www.cnbc.com/video/2020/09/09/how-to-close-the-credit-and-capital-gap.html
[11] More about Project REACh is available at http://occ.gov/reach.

Community Reinvestment Act (CRA) framework for national banks and savings associations.[12] That rule culminated a multi-year rulemaking process,[13] was informed by extensive outreach and public comment, and more than a decade of conversation on how to improve the federal banking system. That process included nationwide listening sessions,[14] a joint report to Congress from regulators identifying opportunities to improve CRA,[15] recommendations from the U.S. Treasury,[16] a report of feedback gathered by the FRB,[17] extensive stakeholder outreach, and a healthy and robust dialogue originating from an the initial ANPR published in August 2018.[18]

The rule addresses much needed improvement over the previous framework that was not working to address the major indicators of economic inequality and social justice which have seen little to no improvement since the regulation was last updated in 1995. Since the rules were last updated, the wealth gap has increased[19] and minority home ownership has remained virtually unchanged, with African-American homeownership sinking below 1968 levels.[20] Banks have closed thousands of branches, disproportionately affecting LMI areas and minority populations,[21] leaving millions with fewer, if any, local options to satisfy basic banking and financial service needs. Because the previous CRA framework relied entirely on branch geography, closing branches virtually eliminated banks' obligations to serve those areas, even if they maintained significant business interests there. If the previous status quo failed to make the economic conditions of many communities better, it altogether ignored other economically disadvantaged

[12] "OCC Finalizes Rule to Strengthen and Modernize Community Reinvestment Act Regulations." News Release 2020-63. May 20, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-63.html).
[13] Initial ANPR was published August 28, 2018. See "OCC Seeks Comments on Modernizing Community Reinvestment Act Regulations." News Release 2018-87. August 28, 2018 (https://occ.gov/news-issuances/news-releases/2018/nr-occ-2018-87.html).
[14] "CRA Public Hearings Held Summer 2010." Federal Financial Institutions Examination Council (FFIEC). June-August 2010 (https://www.ffiec.gov/cra/hearings.htm).
[15] *Joint Report to Congress: Economic Growth and Regulatory Paperwork Reduction Act*. FFIEC. March 2017 (https://www.ffiec.gov/pdf/2017_FFIEC_EGRPRA_Joint-Report_to_Congress.pdf).
[16] "Treasury Releases Community Reinvestment Act Modernization Recommendations." U.S. Department of Treasury. April 3, 2018 (https://home.treasury.gov/news/press-releases/sm0336).
[17] *Perspectives from Main Street: Stakeholder Feedback on Modernizing the Community Reinvestment Act*. Board of Governors of the Federal Reserve System. June 2019. (https://www.federalreserve.gov/publications/files/stakeholder-feedback-on-modernizing-the-community- reinvestment-act-201906.pdf).
[18] OCC News Release 2018-87, "OCC Seeks Comments on Modernizing Community Reinvestment Act Regulations." August 28, 2018 (https://occ.gov/news-issuances/news-releases/2018/nr-occ-2018-87.html).
[19] Kriston McIntosh, Emily Moss, Ryan Nunn, and Jay Shambaugh. "Examining the Black-white wealth gap." The Brookings Institution. February 27, 2020 (https://www.brookings.edu/blog/up-front/2020/02/27/examining-the-black-white-wealth-gap/).
[20] "Black Homeownership Gap: Research Trends and Why the Growing Gap Matters." Urban Institute. July 16, 2019 (https://www.urban.org/events/black-homeownership-gap-research-trends-and-why-growing-gap-matters).
[21] Nelson D. Schwartz. "Bank Closings Tilt Toward Poor Areas." *New York Times*. February 22, 2011.

communities, such as Native Americans, as well as those living in areas without a bank branch. The framework needed to change if we hoped to achieve different results and begin addressing the inequitable accessibility of credit, capital, and opportunity for these communities.

The final rule reflects the thousands of helpful comments from stakeholders of all kinds on the Advance Notice of Proposed Rulemaking (ANPR) and the Notice of Proposed Rulemaking that was issued with the Federal Deposit Insurance Corporation (FDIC) in December 2019.[22] One of my first priorities when I joined the OCC was to review the many comments received from diverse stakeholders, and to make changes to the proposal to accommodate those suggestions in useful ways. The changes made in response to the comments significantly improved the rule and made it different in important ways from the original proposal.

The rule improves upon the previous status quo by clarifying what qualifies for CRA consideration, by evaluating bank activity more objectively, by requiring banks to lend and invest wherever they have branches and receive a significant amount of their deposits, and by making reporting and recordkeeping timelier and more transparent. The rule increased and established new benefits for low and moderate-income populations, Indian Country, small and family-owned farms, and small business owners with the intent of driving more investment, lending, and services where they are needed most.

On September 21, 2020, the FRB published an ANPR soliciting public comments on how the FRB could improve its CRA framework that applies to state-chartered banks that are members of the Federal Reserve System.[23] The OCC welcomes the FRB's ANPR soliciting comments on how to improve the CRA framework for state-chartered, Fed-member banks. Public input and discourse fuels continuous improvement, and we look forward to reviewing the comments for potential insight into our own rulemaking that applies to national banks and savings associations. We are encouraged by our fellow regulators joining us in recognizing that we need to act to improve upon a system that was not working and to encourage banks to do more to support the communities they serve. We are pleased to see that many of the principles on which we worked together and that the OCC, FDIC, and FRB agreed upon prior to the finalization of the OCC rule in May will be part of their rulemaking discussion.

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[22] "FDIC and OCC Propose to Modernize Community Reinvestment Act Regulations." News Release 2019-147. December 12, 2019 (https://occ.gov/news-issuances/news-releases/2019/nr-ia-2019-147.html).
[23] "Federal Reserve Board issues Advance Notice of Proposed Rulemaking on an approach to modernize regulations that implement the Community Reinvestment Act." News Release. Board of Governors of the Federal Reserve System. September 21, 2020 (https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm).

I appreciate the Senate upholding the OCC rule in its vote on October 19, 2020.[24] By supporting the OCC rule, the Senate preserved important gains for LMI neighborhoods, Indian Country, farmers, and small businesses.

***Expanding the Availability of Credit***

**Small Dollar Lending Opportunities**

Millions of Americans rely upon short-term small-dollar credit to make ends meet. Consumers need safe, affordable choices, and banks should be part of that solution. Banks are well-suited to offer affordable short-term small-dollar lending options that can help consumers find a path to more mainstream financial services without trapping them in cycles of debt. To facilitate banks offering responsible short-term small-dollar installment loans to help meet the credit needs of their customers, the OCC published a bulletin in May 2018 setting out the core principles for banks that offer these products.

Building on this bulletin and in recognition of the important role of small dollar loans in meeting customer needs, in May 2020, the OCC joined the FRB, FDIC, and National Credit Union Administration (NCUA) in issuing "Interagency Lending Principles for Offering Responsible Small-Dollar Loans" that sets forth core lending principles for banks that offer small-dollar loans. In all programs, responsible lending products are offered in a manner that ensures fair access to financial services, fair treatment of customers, and compliance with applicable laws and regulations, including fair lending and consumer protection laws.

This year, the OCC has had discussions with several banks that are considering new small-dollar products, and some banks have initiated these offerings. The OCC is encouraged by the new activity in this area which has the potential to provide additional safe and appropriate products to assist consumers.

**Legal Certainty Will Encourage Lending**

Two important agency rulemakings that have been associated with small-dollar lending involve the "valid when made" and "true lender" concepts. On my first day as Acting Comptroller, I signed a final rule that provides legal certainty regarding the sanctity of a contract which holds that an interest term that is valid at the time a contract is ratified remains valid for the life of that contract.[25]

[24] John Heltman (October 19, 2020). "Senate fails to overturn OCC's CRA revamp." *American Banker* (https://www.americanbanker.com/news/senate-fails-to-overturn-occs-cra-revamp).
[25] "OCC Issues Rule to Clarify Permissible Interest on Transferred Loans." News Release 2020-71. May 29, 2020

The primary problem the rule addresses is the legal uncertainty resulting from the Madden v. Midland Funding, LLC decision,[26] and the OCC has observed considerable evidence of this uncertainty. Based on its supervisory experience, the OCC believes that this legal uncertainty has the potential to disrupt banks' ability to serve consumers, businesses, and the broader economy in an efficient and effective manner, particularly in times of stress. The rule supports the orderly function of markets and promotes the availability of credit by answering the legal uncertainty created by the "Madden" decision. Such certainty allows secondary markets to work efficiently and to serve their essential role in the business of banking and helping banks access liquidity and alternative funding, improve financial performance ratios, and meet customer needs. The legal certainty in the rule facilitates responsible lending by banks, especially in the current environment where access to credit by creditworthy consumers is essential. The rule is not intended to create opportunities for predatory lenders to export high interest rates through rent-a-charter relationships with banks, and the OCC will continue to vigorously oppose such relationships.

In fact on October 27, 2020, the OCC issued a companion final rule regarding "true lender," that for the first time defines what it means to be the "true lender" of a loan including in the context of a partnership between a bank and a third party.[27] Banks' lending relationships with third parties can facilitate access to affordable credit. However, the relationships have been subject to increasing uncertainty about the legal framework that applies to loans made as part of these relationships. This uncertainty may discourage banks and third parties from entering into relationships, limit competition, and chill the innovation that results from these partnerships—all of which may restrict access to affordable credit. The final rule resolves this uncertainty by specifying that a bank makes a loan and is the "true lender" if, as of the date of origination, it (1) is named as the lender in the loan agreement or (2) funds the loan.

In contrast to criticisms that this rule potentially leads to predatory lending through rent-a-charter arrangements, I firmly believe the rule will achieve the opposite. In addition to defining "true lender," the rule clarifies that if a bank is the "true lender" of a loan it is ultimately accountable for the applicable compliance obligations attached to the origination of that loan. Thus, the rule negates the ability for banks to originate and walk away from the responsibility for those loans. This will result in eliminating the greatest risk associated with abusive rent-a-charter

(https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-71.html).
[26] 786 F.3d 246 (2d Cir. 2015).
[27] "Office of the Comptroller of the Currency Issues True Lender Rule." News Release 2020-139. October 27, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-139.html).

arrangements.

The "valid when made" and "true lender" rules increase credit availability by ensuring that secondary markets can function efficiently, resulting in lower interest rates. The two rules provide the regulatory framework banks need to form healthy third-party lending partnerships, including those with fintech companies, which can expand economic opportunity because fintechs reach customers who are otherwise unserved.

**Supporting New Technologies and Platforms for Banking Services**

Consumers, businesses and markets continue to embrace innovation and seek out new technologies and platforms to access banking services. These new technologies and process developments are also enhancing bank operations and enabling financial institutions—including small and rural banks—to quickly and more effectively meet the needs of their customers and communities. Moreover, responsible innovation is continuing to help expand services to unbanked and underbanked consumers and promote financial inclusion.

Over the past several years, the OCC has been a regulatory leader in supporting the development of prudent, safe and sound, and fair infrastructure for innovative products and services through several programs and activities.[28] I am proud of the OCC's work around responsible innovation to enable the federal banking system to respond to the new technologies and the changing needs of bank customers.

I also want to recognize the critical importance of the agency's initiative to maintain a regulatory framework that supports a continued home in the highly regulated banking system for banking activities that have been migrating into the shadow banks. We have previously witnessed the catastrophic consequences for consumers and communities when federal regulators do not have an adequate view into instances of accumulating systemic risk and a reduced ability to ensure that banking activities are conducted in a safe, sound, and fair manner, with associated consumer protections firmly in place.

**The National Bank Charter Accommodates a Variety of Business Models**

As consumer and business financial service needs evolve, it is critical that the national bank charter continue to adapt to emerging trends and technology as it has done since 1863. Since its creation, the federal banking system has always adapted to banking innovations. It took the

[28] Testimony of Beth Knickerbocker, OCC Chief Innovation Officer, before the Task Force on Fintech, June 25, 2019 (https://www.occ.gov/news-issuances/congressional- testimony/2019/ct-2019-70-written.pdf).

Supreme Court in 1870 to clarify that national banks may issue certified checks—highly controversial then but taken for granted now. In the late 1960s, at the dawn of the computer age, our agency again fought all the way to the high court to establish that banks could offer data-processing services. In the early 1990s, the justices held that banks could offer variable annuities because those products served the same purpose as savings accounts. In each of these cases, the forces of the status quo fought change, but progress prevailed to allow the federal banking system to evolve to meet the needs of the customers banks serve. All of these innovations, controversial at the time, are now well accepted banking products and services that customers have come to expect.

The ability of the national bank charter to adapt to emerging trends and innovations is more critical now than ever given the depth and breadth of innovation and the decentralization and unbundling of financial services and products. In an article for the *Wall Street Journal*, cowritten by Senior Deputy Comptroller and OCC Chief Economist Dr. Charles Calomiris,[29] we note that, before the financial crisis, national banks conducted the majority of consumer lending and virtually all payment activity in the United States. But the past decade witnessed dramatic change. By 2018 banks' share of personal loans fell to 28 percent while fintech's share of that market rose to 38 percent.[30] Fintech unicorns such as Square, PayPal and Stripe have similarly captured a large and growing segment of the payments business that national banks previously dominated. Further, these banking products and services are migrating to less regulated and supervised entities, without the foundational framework of traditional banking supervision.

This is why it is imperative that the OCC, through its chartering authority, provide a robust supervision framework for companies that provide banking products. In December 2016, Comptroller of the Currency Thomas Curry thoughtfully considered the relationship between innovation and the business of banking and concluded that a national bank charter is flexible enough to accommodate innovative financial technology firms. The research conducted, comments received, and resulting supervisory framework[31] is explained in the *Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies*.[32]

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[29] Brian P. Brooks and Charles Calomiris. "Fintech Can Come Out of the Shadows." *Wall Street Journal*. September 9, 2020 (https://www.wsj.com/articles/fintech-can-come-out-of-the-shadows-11599693184).
[30] Kate Rooney. "Fintechs help boost US personal loan surge to a record $138 billion." CNBC. February 21, 2020 (https://www.cnbc.com/2019/02/21/personal-loans-surge-to-a-record-138-billion-in-us-as-fintechs-lead-new-lending-charge.html).
[31] "OCC Adopts Framework for Receiverships for Uninsured Federally Chartered National Banks." News Release 2016-160. December 10, 2016 (https://occ.gov/news-issuances/news-releases/2016/nr-occ-2016-160.html).
[32] *Comptroller's Licensing Manual Supplement: Considering Charter Applications From Financial Technology Companies*. OCC. July 2018 (https://occ.gov/publications-and-resources/publications/comptrollers-licensing-

On December 19, 2019, the OCC appealed a decision by the U.S. District Court for the Southern District of New York that blocks the agency's issuance of special purpose national bank charters to businesses engaged in banking but that do not take deposits. In appealing the court's decision, the OCC is defending long standing authority granted by the National Bank Act to charter national banks, including special purpose national banks that engage in at least one of the core banking functions—paying checks or lending money or taking deposits. The OCC's brief in the case was filed on April 23, 2020. I expect the litigation to be favorably resolved so that this charter option will remain available to companies engaged in any combination of the widely recognized core functions of banking. The OCC supports the dual banking system and recognizes that companies engaged in functions inherent to the business of banking should have choices to conduct their businesses through a national bank charter, state charter or state license. Charter choice is a keystone of the U.S. banking system. The national charter should remain available when it makes sense for a company's business model and the company meets the rigorous and high standards and criteria for becoming a national bank, whether that company provides a broad range of services or a more limited range of banking activities.

Several mature fintech companies, offering products and services historically provided by banks, have already made that choice. This year, we approved new entrants into the national banking system that employ new technologies and business models including Varo Bank, Jiko and SoFi. These institutions have received full service national bank charters (or been granted preliminary approval for a charter in the case of SoFi) and are expected to maintain sufficient capital and liquidity levels, comply with appropriate rules and consumer protections, and be subject to stringent OCC supervision as required of every national bank. There remains significant interest in federal charters, including full service and limited purpose charters such as the national trust bank charter, by companies seeking to offer products and services under the robust supervision of the OCC.

**Responding to Industry Cryptocurrency and Stablecoin Use**

Today, roughly 60 million Americans own some type of cryptocurrency, with a total market cap of nearly $430 billion.[33] These figures clearly illustrate that this payment mechanism is now firmly entrenched in the financial mainstream. Cryptocurrency has become a popular

manual/files/pub-considering-charter-apps-from-fin-tech-co.pdf).

[33] See: https://www.forbes.com/sites/ronshevlin/2020/07/27/the-coronavirus-cryptocurrency-craze-whos-behind-the-bitcoin-buying-binge/#578251402abf

mechanism for sending and receiving payments for goods and services because transactions post in real time and provide convenience and security. Cryptocurrency also describes categories of specific currencies of value, and the rise in the use of stablecoins demonstrates consumers' comfort with its use.

This year, the OCC took two actions to respond to specific questions from the industry regarding cryptocurrencies, distributed ledger technology and stablecoin activity already being conducted or considered by banks the OCC oversees. Our actions have clarified authority and regulatory expectations for banks in ways that reduce the overall risk to the banking system and support its continuous evolution and innovation.

On July 22, 2020, the OCC published an interpretive letter clarifying national banks' and federal savings associations' authority to provide cryptocurrency custody services for customers.[34] National and state banks and thrifts have long provided safekeeping and custody services, including physical objects and electronic assets. The OCC has specifically recognized the importance of digital assets and the authority for banks to provide safekeeping for such assets since 1998. The July letter simply concludes that providing cryptocurrency custody services, including holding unique cryptographic keys associated with cryptocurrency, is a modern form of traditional bank activities related to custody services.

On September 21, 2020, the OCC published a second interpretive letter to clarify bank's authority to hold reserves on behalf of customers who issue certain stablecoins.[35] The letter responded to questions from the industry and concluded that banks may hold "reserves" on behalf of customers who issue stablecoins in situations where the coins are purchased by customers through hosted wallets. The letter addresses the use of stablecoins backed by a single fiat currency on a one-to-one basis where the bank verifies at least daily that reserve account balances meet or exceed the number of the issuer's outstanding stablecoins.

The agency continues to consider other issues relevant to cryptocurrency assets and distributed ledger technology including the application of the technology to support payments services conducted within the federal banking system.

**OCC's Office of Innovation Provides Assistance and Clarity to the Industry**

The OCC's Office of Innovation serves as a resource for the banks we supervise to discuss

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[34] "Federally Chartered Banks and Thrifts May Provide Custody Services For Crypto Assets." News Release 2020-98. July 22, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html).
[35] Stablecoins are digital tokens representing fiat currency on a fixed one-to-one ratio.

emerging trends including partnerships with fintech firms, and as a source of information to the fintech industry and OCC employees about innovation. The Office provides training and awareness materials for OCC's examiners and engages the industry through a number of outreach events annually. Earlier this year, I participated in a series of listening sessions[36] around the PPP held in response to feedback from banks and trade associations regarding several technology and other challenges they identified. The OCC facilitated discussions between banks and financial technology companies about possible technology solutions[37] available to assist banks in overcoming the challenges identified and to scale up participation in the PPP quickly to serve the needs of small businesses. Nearly 200 banks, nonbanks, and other industry stakeholders attended each of these calls. The OCC has made the summaries of the calls available on its public website. Given the response to these listening sessions, the OCC anticipates holding other similar sessions on emerging topics and trends on a more frequent basis.

Currently, I also am working to support our Office of Innovation in developing capabilities to evaluate emerging technologies and developments to reduce regulatory uncertainty, promote responsible innovation, and support community banks' ability to adapt new technologies to improve the efficiencies of their operations and the quality of the products and services delivered to their customers. Called, "Evolve," this function builds on the OCC's innovation initiatives and expands on the OCC's strategic goals to provide constructive, effective and proactive supervision, and to be a valuable resource to the banking industry. Evolve provides a process for the OCC to study emerging trends and engage with multiple entities where regulatory uncertainty might otherwise stifle innovation. Evolve provides a framework for the OCC to complete a more in-depth analysis of innovative activities raising industry-wide questions with a variety of impacted entities, including nonbanks.

The OCC also is seeking additional information regarding the range of digital activities conducted by banks and clarifying the existing authorities that national banks and federal savings associations have regarding new and emerging capabilities.

In June, the agency also published an NPR proposing to update its rules for national bank and federal savings association activities and operations. On the same date, the agency released an

[36] Listening sessions are used to inform the OCC and participants about emerging topics, issues, or concerns of stakeholders such as banks and nonbanks, including financial technology companies. The goal of listening sessions is to encourage an open dialogue between participants. Listening sessions are not intended to result in a group consensus on recommendations to guide OCC policy or regulation.

[37] The OCC does not endorse any particular solutions, companies, or technologies.

ANPR seeking comment on rules addressing banks' digital activities.[38] The ANPR invited comment on the OCC's regulations at 12 CFR 7, subpart E and 155, and any other banking issues related to digital technology and innovation, including:

- whether the legal standards in 12 CFR 7, subpart E, and 12 CFR 155 are sufficiently flexible and clear in light of the technological advances that have transformed the financial industry over the past two decades;
- whether these legal standards create unnecessary hurdles or burdens to innovation by banks;
- whether there are digital banking activities or issues that are not covered by these rules that the OCC should address (e.g., digital finders' activities, certain software, and correspondent services);
- what activities related to cryptocurrencies or cryptoassets are financial services companies or bank customers engaged in and what are the barriers or obstacles to further adoption of crypto-related activities in the banking industry;
- how is distributed ledger technology used or potentially used in activities related to banking;
- how are artificial intelligence and machine learning techniques used or potentially used in activities related to banking;
- what new payments technologies and processes should the OCC be aware of and what are the potential implications of these technologies and processes for the banking industry;
- what new or innovative tools do financial services companies use to comply with regulations and supervisory expectations (i.e., "regtech");
- what issues are unique to smaller institutions regarding the use and implementation of innovative products, services, or processes that the OCC should consider;
- what other changes to the development and delivery of banking products and services should the OCC be aware of and consider; and
- whether there are issues the OCC should consider in light of changes in the banking system that have occurred in response to the COVID-19 pandemic.

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[38] "OCC Requests Comment on Proposal to Update Activities and Operations Rules and its Rules on Digital Activities." News Release 2020-76. June 4, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-76.html).

The comment period closed on August 3, 2020, and the agency is reviewing those comments to determine additional actions.

***Fair Access to Banking Services and Products***

The Dodd-Frank Act clarified the OCC's mission by emphasizing our role in ensuring fair access to financial services and treating customers fairly.[39] When allegations surface that a bank or group of banks may be denying access to banking products and services including deposit and other account services to entire categories of customers engaged in legal businesses, it raises questions. The regulators' role is to answer those questions.

That is why the OCC sought additional information from large banks related to their provision of services to oil and gas companies. Upon hearing allegations that such businesses which affect all Americans were being curtailed, the agency in September requested information from the banks we oversee. We are in the process of reviewing the responses to that request to help us analyze whether bank actions were taken based on risk assessments and consistent with the bank's policies and procedures, or if they violate any duty or obligation under the law. We will assess our options for affirmative steps to ensure the federal banking system continues to serve our nation by providing fair access to all legal businesses and consumers.

As the agency has stressed repeatedly and for more than a decade, the OCC, as a general matter, does not recommend or encourage banks to engage in the wholesale termination of categories of customer accounts. Rather, we expect banks to assess the risks posed by individual customers on a case-by-case basis and to implement appropriate controls to manage each relationship. No matter what type of business banks engage, bankers have to exercise sound judgment, conduct appropriate due diligence, and evaluate customers individually.

***Holding Banks Accountable***

At its core, effective bank supervision ensures that OCC-regulated institutions that serve large and small businesses and customers across the nation do so in a manner consistent with legal and regulatory requirements. OCC-regulated institutions are subject to comprehensive, ongoing supervision designed to enable examiners to identify problems early and obtain corrective action quickly. Such supervision permits most bank problems to be resolved through the supervisory process via official transmittals in Reports of Examination, Supervisory Letters, and Matters Requiring Attention tailored to specific bank weaknesses. Sometimes, however, supervisory

[39] 12 USC 1(a)

actions fail to remedy the problem, or the seriousness of the problem requires a heightened enforcement response. In those instances, the OCC has a range of tools available ranging from informal enforcement actions such as a commitment letter to formal enforcement actions such as a formal agreement, cease and desist order or removal and prohibition order. Depending on the circumstances, the OCC selects the best approach to swiftly and forcefully require a bank to take corrective action.

Since I became Acting Comptroller, the OCC has taken a number of enforcement actions. Last month, the OCC took three significant enforcement actions and assessed a total of $545 million in civil money penalties. On October 7, 2020, the OCC fined Citibank $400 million and required corrective actions related to deficiencies in its enterprise-wide risk management, compliance risk management, data governance and internal controls.[40] On October 8, the OCC fined Morgan Stanley Bank and Morgan Stanley Private Bank $60 million in response to their failure to exercise proper oversight of the 2016 decommissioning of two Wealth Management business data centers.[41] The following week, on October 14, the OCC assessed an $85 million fine against USAA, due to the bank's failure to implement and maintain an effective compliance risk management program and effective informational technology risk governance program, and required the bank remedy these programs.

In addition, if an individual bank employee operates in such a way that jeopardizes the safety and soundness of the institution or causes consumer harm, the OCC will hold those individuals accountable. On September 21, 2020, the OCC announced settlements with three former senior executives at Wells Fargo Bank in response to their role in the bank's widespread sales practices misconduct.[42] These settlements were in addition to the actions the OCC announced on January 23, 2020, including the issuance of charges against five other former senior bank executives and settlements with three others. The OCC has a proven track record to take public enforcement actions when the supervisory process fails to adequately remediate bank deficiencies.

***Streamlining Bank Secrecy Act and Anti-Money Laundering Compliance***

Ensuring compliance with the provisions of the Bank Secrecy Act (BSA) and other Anti-

[40] "OCC Assesses $400 Million Civil Money Penalty Against Citibank," October 7, 2020, News Release 2020-132 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-132.html).
[41] "OCC Assesses $60 Million Civil Money Penalty Against Morgan Stanley," October 8, 2020, News Release 2020-132 (https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-134.html).
[42] "OCC Announces Settlements With Three Former Senior Wells Fargo Bank Executives," September 21, 2020, News Release 2020-124 (https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-124.html).

Money Laundering (AML) regulations remains a key area of OCC supervisory focus in order to better protect the financial system from criminals who would exploit it for their own illegal purposes or use it to finance terrorism. At the same time, the OCC continues to work toward improving the BSA regime by reducing unnecessary burden associated with some existing practices. The OCC has supported the bipartisan work of the Congress this session to consider legislative reform that would promote both goals.

The success of the BSA/AML compliance regime in achieving its objective of preserving the integrity of the financial system is based on its efficiency and effectiveness. To this end, the OCC has had a leadership role in coordinating with the other federal regulatory agencies, Treasury's Office of Terrorism and Financial Intelligence, and the Financial Crimes Enforcement Network (FinCEN) efforts to streamline BSA/AML compliance, while reducing unnecessary compliance burden and meeting the needs of law enforcement. Increased transparency and clarity on how we supervise for BSA/AML compliance have been key characteristics of our strategic approach to strengthening the compliance regime.

In April 2020, the OCC joined with the other FFIEC agencies in issuing updates and revisions to sections of the BSA/AML examination manual that bank examiners use to evaluate compliance with the BSA/AML requirements. These updates offer further transparency into the examination process and incorporate recent regulatory changes. The overall objective of this year's update was to clearly distinguish mandatory regulatory requirements from supervisory expectations set forth in guidance, and to increase transparency into the agencies' risk-focused approach to BSA/AML supervision. These goals were not sufficiently addressed in previous versions of the manual.

In August 2020, the agencies issued a joint statement clarifying BSA due diligence requirements for customers who may be considered politically-exposed persons.[43] The agencies also updated the interagency statement on enforcement enhancing transparency regarding how they evaluate enforcement actions that are required by statute when financial institutions fail to meet their BSA/AML obligations.[44] The agencies are continuing to collaborate with law enforcement on

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[43] "Joint Statement on Bank Secrecy Act Due Diligence Requirements for Customers Who May Be Considered Politically Exposed Persons." August 21, 2020 (https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-77.html).

[44] "Joint Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements." August 13, 2020 (https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-105.html).

informational needs to support the fight against criminal activities, as well as working on additional clarifying guidance for industry and updates to other sections of the FFIEC manual.

The OCC also recognizes that efforts to streamline BSA/AML compliance can benefit significantly from advances in technology, especially in monitoring suspicious activity to generate information of importance to law enforcement. In keeping with our commitment to promoting innovation, we joined with the other agencies in December 2018 to issue a joint statement encouraging banks to consider the use of innovative technologies for increasing efficient and effective anti-money laundering compliance.[45] The OCC put the spirit of this statement into action in 2019, when we published an interpretive letter setting forth our conclusion that a bank's automated filing proposal for suspicious activity reports (SARs) involving certain structuring transactions was permissible, subject to the conditions outlined in the letter and representations made by the bank.[46] Most recently, the OCC supported FinCEN's development and issuance of an Advance Notice of Proposed Rulemaking that seeks comment and input relating to agency efforts to explicitly integrate and define an effectiveness requirement for BSA compliance programs. Clearly defining BSA/AML effectiveness to include bank efforts that address national strategic priorities in a manner that is consistent with the bank's risk profile will support innovative efforts by banks to enhance the effectiveness and efficiency of the BSA/AML regime and improve the security of our nation's financial system.

***OCC's Commitment to Diversity and Inclusion***[47]

The OCC relies on a committed workforce of more than 3,500 individuals to fulfill its mission, and the strength of this workforce depends on how effectively the agency recruits and retains management and staff who have a wide range of diverse perspectives, experiences, and backgrounds. Over the past ten years, the OCC's total minority population has increased, and both manager and senior-level manager positions held by minority and female populations also have increased.[48] Today, the composition of the OCC Executive Committee is 22 percent minority and 44 percent female, compared to 13 percent and 25 percent, respectively, in 2010.

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[45] "Agencies Issue a Joint Statement on Innovative Industry Approaches." News Release 2018-130.December 3, 2018 (https://occ.gov/news-issuances/news-releases/2018/nr-occ-2018-130.html).
[46] "Request for interpretive letter to streamline SARs for potential structuring activity." OCC Interpretive Letter 116. September 27, 2019 (https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2019/int1166.pdf).
[47] Testimony of OMWI Director Joyce Byrd Cofield before the House Financial Services Subcommittee on Diversity and Inclusion, September 8, 2020 for a detailed explanation of our diversity and inclusion programs (https://www.occ.gov/news-issuances/congressional-testimony/2020/ct-occ-2020-118-written.pdf).
[48] The OCC's minority population has increased from 30 to 36 percent. Manager positions held by minority and female populations increased from 21 to 28 percent and 37 to 39 percent respectively. Senior level manager positions

The OCC engages in comprehensive hiring, recruitment and employee retention strategies to support efforts to expand agency diversity. We also provide a wide range of formal and informal career development opportunities to provide leadership skills to our employees, which are crucial for career development. Additionally, the OCC has eight employee network groups,[49] each of which serve as a collective voice in communicating workplace concerns and providing input to management around diversity and inclusion programs within the OCC. These have proven to be a valuable means to attract and retain employees from diverse backgrounds and create an inclusive work environment for all employees. Finally, this past summer, the OCC continued its High School Scholars Internship Program, a six-week paid internship for students from public and charter high schools in the District of Columbia. This program provides an opportunity for participants to explore a variety of career paths at the OCC, gain an understanding of the financial services industry, and engage in enrichment activities on financial literacy and leadership fundamentals. Teams at the OCC already have begun planning for our third year of hosting the program at the agency next summer.

***Conclusion***

The OCC is committed to ensuring that the national banking system operates in a safe and sound manner, provides fair access to services and fair treatment of customers. As the economy, consumers and businesses respond to and recover from the coronavirus pandemic, we are doing our part to ensure that the national banking system continues to serve as a source of strength, extends opportunities to underserved citizens, and remains committed to the appropriate use of technology.

held by minority and female employees increased from 20 to 25 percent and 27 to 30 percent respectively.

[49] These employee network groups are the Coalition of African-American Regulatory Employees (CARE); Generational Crossroads; HOLA; Network of Asian Pacific Americans (NAPA); PRIDE; The Women's Network (TWN); Veterans Employee Network (VEN); and the Differently Abled Workforce Network (DAWN).

**Appendix 1**

**OCC Issuances to Provide Support to Banks and Customers in Response to COVID-19**

Below is a list of issuances the OCC issued individually or together with other regulatory bodies to provide support and guidance to supervised institutions and their customers while the country responds to the COVID-19 pandemic. Each issuance can be accessed in its entirety on the OCC's website.

- On March 6, 2020, the Federal Financial Institutions Examination Council (FFIEC) issued the *Interagency Statement on Pandemic Planning* that identifies actions that financial institutions should take to minimize the potential adverse effects of a pandemic, recognizing that sound planning in advance of any imminent risk helps to reduce disruptions in services to consumers, businesses, and communities when such contingencies occur.[50]
- On March 9, 2020, the federal bank regulators issued a news release encouraging financial institutions to work constructively with borrowers and other customers affected by COVID-19 related issues. The release stated that prudent efforts that are consistent with safe and sound lending practices should not be subject to examiner criticism.[51]
- On March 13, 2020, the OCC issued guidance recognizing the potential for COVID-19 related issues to affect the customers and operations of banks and providing further encouragement to banks to work with borrowers.[52] The statement also emphasizes that prudent efforts to modify terms on existing loans such as deferring payments or extending payment due dates, will not be subject to examiner criticism.
- On March 16, 2020, federal bank regulators encouraged banks to use the Federal Reserve's "discount window" so that they can continue supporting households and businesses.[53]
- On March 17, 2020, federal bank regulators published an interim final rule to phase in the

[50] OCC Bulletin 2020-13, "Pandemic Planning: Updated FFIEC Guidance." March 6, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-13.html).
[51] OCC News Release 2020-30, "Agencies Encourage Financial Institutions to Meet Financial Needs of Customers and Members Affected by Coronavirus." March 9, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia- 2020-30.html).
[52] OCC Bulletin 2020-15, "Pandemic Planning: Working With Customers Affected by Coronavirus and Regulatory Assistance." March 13, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-15.html).
[53] OCC News Release 2020-32, "Federal Banking Agencies Encourage Banks to Use Federal Reserve Discount Window." March 16, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-32.html).

automatic distribution restrictions gradually if a bank's capital levels decline and a statement encouraging banks to use their resources to support households and businesses.[54] Clarifying questions and answers were published on March 19, 2020.[55]

- On March 19, 2020, federal bank regulators announced an interim final rule to ensure that financial institutions will be able to effectively use the Money Market Mutual Fund Liquidity Facility established by the Federal Reserve Board (FRB).[56]
- On March 19, 2020, the federal bank regulators issued a statement encouraging financial institutions to work with affected customers and communities, particularly those that are low- and moderate-income (LMI), and clarifying that financial institutions will receive Community Reinvestment Act (CRA) consideration for qualifying community development activities.[57]
- On March 20, 2020, the OCC encouraged electronic submission of licensing filings to greater support remote processing while continuing to support the federal banking system's orderly operations.[58]
- On March 22, 2020, the federal and state bank regulators issued an interagency statement encouraging financial institutions to work constructively with borrowers affected by COVID-19 and providing additional information regarding loan modifications.[59] The agencies encourage financial institutions to work with borrowers, will not criticize institutions for doing so in a safe and sound manner, and will not direct supervised institutions to automatically categorize loan modifications as troubled debt restructurings. The joint statement also provides supervisory views on past-due and nonaccrual regulatory reporting of loan modification programs.

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[54] OCC News Release 2020-34, "Federal Banking Agencies Provide Banks Additional Flexibility to Support Households and Businesses." March 17, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-34.html).
[55] OCC Bulletin 2020-17, "Pandemic Planning: Joint Questions and Answers Regarding Statement About the Use of Capital and Liquidity Buffers." March 19, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-17.html).
[56] OCC News Release 2020-36, "Federal Bank Regulatory Agencies Issue Interim Final Rule for Money Market Liquidity Facility." March 19, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-36.html).
[57] OCC Bulletin 2020-19, "Pandemic Planning: Joint Statement on Community Reinvestment Act Consideration for Activities in Response to COVID-19." March 19, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin- 2020-19.html).
[58] OCC Bulletin 2020-20, "Licensing Filings: Use of Electronic Methods for Submission of Licensing Filings." March 20, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-20.html).
[59] OCC News Release 2020-39, "Agencies Provide Additional Information to Encourage Financial Institutions to Work with Borrowers Affected by COVID-19." March 22, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-39.html).

- On March 22, 2020, the OCC announced an interim final rule to revise its short-term investment fund rule for national banks acting in a fiduciary capacity.[60] The rule allows the OCC to authorize banks to temporarily extend maturity limits of these funds because the financial markets are in a period of significant stress negatively affecting the ability of banks to operate in compliance with maturity limits identified in the rule.
- On March 25, 2020, the OCC published a bulletin notifying regulated institutions of relief for regulatory reporting for institutions affected by COVID-19.[61]
- On March 25, 2020, the OCC published a bulletin providing information for essential critical infrastructure workers during the COVID-19 emergency response.[62]
- On March 26, 2020, the federal bank regulators encouraged regulated financial institutions to support their customers by offering more responsible short-term small-dollar lending products.[63] The OCC issued a bulletin emphasizing the statement for banks and thrifts.[64]
- On March 26, 2020, the OCC issued a statement describing the strength and resiliency of the federal banking system in light of COVID-19.[65]
- On March 27, 2020, the federal bank regulators issued two interim final rules: the first involved the standardized approach for measuring counterparty credit risk, or SA-CCR, and the second addressed the "current expected credit loss," or CECL, accounting standard in bank regulatory capital.[66]
- On March 31, 2020, the federal bank regulators issued a joint statement on the interaction of the revised transition of the CECL method for allowances with section 4014 of the CARES Act.[67]

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[60] News Release 2020-38, "OCC Revises Short-Term Investment Fund Rule." March 22, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-38.html).
[61] OCC Bulletin 2020-24, "Consolidated Reports of Condition and Income: 30-Day Grace Period for the March 31, 2020, Call Report Date." March 25, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-24.html).
[62] OCC Bulletin 2020-23, "Pandemic Planning: Essential Critical Infrastructure Workers in the Financial Services Sector." March 25, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-23.html).
[63] OCC News Release 2020-40, "Federal Agencies Encourage Banks, Savings Associations and Credit Unions to Offer Responsible Small-Dollar Loans to Consumers and Small Businesses Affected by COVID-19." March 26, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-40.html).
[64] OCC Bulletin 2020-25, "Small-Dollar Lending: Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19." March 26, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-25.html).
[65] OCC News Release 2020-41, "Statement of the Comptroller of the Currency on the Condition of the Federal Banking System and the Response to COVID-19." March 26, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-41.html).
[66] OCC News Release 2020-42, "Agencies Announce Two Actions to Support Lending to Households and Businesses." March 27, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-42.html).
[67] OCC Bulletin 2020-30, "Regulatory Capital: Joint Statement on the Interaction of the Revised Transition of the

- On April 2, 2020, the OCC made banks and savings associations aware of the new and expanded small business relief programs administered by the U.S. Small Business Administration (SBA), included in the CARES Act.[68]
- On April 3, 2020, the federal bank regulators issued a statement providing needed regulatory flexibility to enable mortgage servicers to work with struggling consumers affected by COVID-19.[69]
- On April 6, 2020, the federal bank regulators announced two interim final rules to implement Section 4012 of the CARES Act, which requires the agencies to temporarily lower the community bank leverage ratio to 8 percent.[70]
- On April 7, 2020, the federal bank regulators, in consultation with state regulators, issued a revised interagency statement to provide additional information to financial institutions that are working with borrowers affected by COVID-19 to provide loan modifications and mortgage relief.[71]
- On April 7, 2020, the OCC issued a bulletin in response to COVID-19 to support FinCEN's regulatory relief and risk-based approach for financial institution compliance with the Bank Secrecy Act (BSA).[72]
- On April 9, 2020, the federal bank regulators released an interim final rule regarding the capital treatment of loans related to the Paycheck Protection Program (PPP).[73]
- On April 14, 2020, the OCC announced it would hold a series of listening sessions with banks and financial technology companies to discuss challenges and solutions to support

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CECL Methodology for Allowances With Section 4014 of the CARES Act." March 31, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-30.html).
[68] OCC Bulletin 2020-31, "Small Business Administration Lending: New Programs for Small Business Relief." April 2, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-31.html).
[69] OCC News Release 2020-48, "Federal Agencies Encourage Mortgage Servicers to Work With Struggling Homeowners Affected by COVID-19." April 3, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia- 2020-48.html).
[70] OCC News Release, "Agencies Announce Changes to the Community Bank Leverage Ratio." April 6, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-49.html).
[71] OCC News Release, "Agencies Issue Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus." April 7, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-50.html).
[72] OCC Bulletin 2020-34, "Bank Secrecy Act/Anti-Money Laundering: OCC Supports FinCEN's Regulatory Relief and Risk-Based Approach for Financial Institution Compliance in Response to COVID-19." April 7, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-34.html).
[73] OCC News Release 2020-51, "Federal Bank Regulators Issue Interim Final Rule for Paycheck Protection Program Facility." April 9, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-51.html).

the effective and efficient implementation of the PPP.[74]

- On April 14, 2020, the federal bank regulators issued an interim final rule to temporarily defer real estate-related appraisals and evaluations under the agencies' interagency appraisal regulations.[75] The agencies also issued a statement to address challenges relating to appraisals and evaluations for real estate-related financial transactions affected by COVID-19.[76]
- April 20, 2020, the OCC published a bulletin providing awareness to banks about facilities and programs established or expanded by the Board of Governors of the Federal Reserve System to assist households and employers of all sizes and bolster the ability of state and local governments to deliver critical services during the COVID-19 emergency.[77]
- April 24, 2020, the OCC published a bulletin recognizing that a wide range of stakeholders, including state and local officials, have an interest in the successful implementation of these programs, but reminding banks that it has exclusive visitorial authority over them.[78]
- April 27, 2020, the OCC released a bulletin to encourage banks providing loans under the Small Business Administration's (SBA) Paycheck Protection Program (PPP) to prudently document their implementation and lending decisions.[79] Additionally, banks are encouraged to identify and track the PPP loans made to small business borrowers that have annual revenues of $1 million or less and are located in LMI areas.
- May 1, 2020, the OCC and the FRB published a response to a frequently asked question about the capital implication under the market risk capital rule in light of current market conditions.[80]

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[74] OCC News Release 2020-53, "OCC Announces Paycheck Protection Program Listening Sessions." April 14, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-53.html).
[75] OCC News Release 2020-54, "Federal Banking Agencies to Defer Appraisals and Evaluations for Real Estate Transactions Affected by COVID-19." April 14, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia- 2020-54.html).
[76] "Interagency Statement on Appraisals and Evaluations for Real Estate Related Financial Transactions Affected by the Coronavirus." April 14, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-54b.pdf).
[77] "Federal Reserve Lending Programs: COVID-19-Related Programs to Support Households, Employers, and Communities." OCC Bulletin 2020-41. April 20, 2020 (Federal Reserve Lending Programs: COVID-19-Related Programs to Support Households, Employers, and Communities).
[78] "COVID-19 Financial Support Programs: Visitorial Authority." OCC Bulletin 202-43. April 24, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-43.html).
[79] "Credit Administration: Documentation of SBA Paycheck Protection Program Loans." OCC Bulletin 2020-45. April 27, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-45.html).
[80] "Market Risk: Joint Response About the Effect of Recent Financial Market Volatility on the Market Risk Capital Rule." OCC Bulletin 2020-47. May 1, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-47.html).

- On May 5, 2020, the federal bank regulators announced an interim final rule to modify the agencies' Liquidity Coverage Ratio (LCR) rule to support banks' participation in the Federal Reserve's Money Market Mutual Fund Liquidity facility and the Paycheck Protection Program Liquidity Facility.[81] The interim final rule neutralizes the LCR impact associated with the non-recourse funding provided by these facilities.
- May 12, 2020, the OCC issued a bulletin to provide banks and savings associations guidance regarding their governance and annual meetings in light of COVID-19.[82] The bulletin responds to inquiries from banks and savings associations considering changes to the date, time, or location of their annual meetings as a result of stay-at-home and similar orders and potential health concerns.
- May 15, 2020, the federal bank regulatory agencies announced temporary changes to their supplementary leverage ratio rule to provide flexibility to certain depository institutions to expand their balance sheets to provide credit to households and businesses in light of the challenges arising from COVID-19.[83]
- On May 26, 2020, the OCC issued an interim final rule to clarify that national banks and federal savings associations may permit telephonic and electronic participation at all board of directors, shareholder, and member meetings.[84]
- On June 17, 2020, the OCC issued a bulletin reminding stakeholders that banks are governed primarily by uniform federal standards.[85] OCC regulations preempt state laws that conflict with the real estate lending powers of banks and specifically preempt state laws that interfere with banks' ability to make mortgage loans secured by real estate. State action that limits banks' ability to foreclose on a defaulted loan and take possession of collateral, beyond what is provided for in the CARES Act, would interfere with banks' powers to make secured mortgage loans.

[81] "Federal Bank Regulatory Agencies Modify Liquidity Coverage Ratio For Banks Participating in Money Market Mutual Fund Liquidity Facility and Paycheck Protection Program Liquidity Facility." News Release 2020-59. May 5, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-59.html).
[82] "Corporate Governance: Annual Meetings and the COVID-19 Emergency." OCC Bulletin 2020-51. May 12, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-51.html).
[83] "Supplementary Leverage Ratio: Interim Final Rule." OCC Bulletin 2020-52. May 15, 2020. (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-52.html).
[84] "Director, Shareholder, and Member Meetings: Interim Final Rule." OCC Bulletin 2020-44. May 26, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-55.html).
[85] "COVID-19 Relief Programs: Preemption." OCC Bulletin 2020-62. June 17, 2020 (https://www.occ.treas.gov/news-issuances/bulletins/2020/bulletin-2020-62.html).

- June 22, 2020, the OCC published an interim final rule to reduce assessments in response to the national emergency declared in connection with the coronavirus disease (COVID-19).[86]
- June 23, 2020, the four federal agencies in conjunction with the state bank and credit union regulators issued examiner guidance to promote consistency and flexibility in the supervision and examination of financial institutions affected by the COVID-19 pandemic.[87]
- August 4, 2020, the OCC issued a rule creating an exception to the withdrawal period requirement for collective investment funds to help ease impact of COVID-19.[88]
- August 7, 2020, the OCC announced it is reducing assessments in response to the national health emergency related to COVID-19.[89]
- August 13, 2020, the OCC published an IFR that revises the requirements in 12 CFR 9.18(b)(5)(iii) applicable to a national bank or federal savings association (collectively, a bank) that administers a collective investment fund (CIF) invested primarily in real estate or other assets that are not readily marketable.[90]
- On September 29, 2020, the federal regulatory agencies finalized two interim final rules. The first would temporarily defer appraisal and evaluation requirements after the closing of certain residential and commercial real estate transactions and the second neutralizes the regulatory and capital and liquidity effects for banks that participate in certain Federal Reserve liquidity facilities.[91]

[86] "Assessments: Interim Final Rule." OCC Bulletin 2020-63. June 22, 2020 (https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-63.html).
[87] "Federal and State Regulatory Agencies Issue Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions." News Release 2020-80. June 23, 2020 (https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-80.html).
[88] "OCC Issues Rule Creating Exception to Withdrawal Period Requirement for Collective Investment Funds, Eases Impact of COVID-19." News Release 2020-100. August 4, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-occ-2020-100.html).
[89] "OCC Reduces September 2020 Assessments in Response to COVID-19." News Release 202-102. August 7, 2020 (https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-102.html).
[90] "Collective Investment Funds: Prior Notice Period for Withdrawals." OCC Bulletin 2020-74. August 13, 2020 (https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-74.html).
[91] "Agencies Issue Two Final Rules." News Release 2020-129. September 29, 2020. (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-129.html).

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Statement by

The Honorable Rodney E. Hooc

before the

Committee on Financial Service

U.S. House of Representatives

November 12, 2020

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee, thank you for the opportunity to discuss the state of the credit union industry and to provide an update on the operations, programs, and initiatives of the National Credit Union Administration (NCUA). On behalf of the NCUA and its Board, I am honored to be here with you today.

The NCUA's mission — to "*provide, through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit*" — is a critical one.[1] Indeed, in touching more than one-third of all households, the credit union system is vital to the American economy. In turn, Congress has charged the NCUA with insuring deposits at federally insured credit unions, protecting the members who own credit unions, and chartering and regulating federal credit unions. The NCUA also is charged with ensuring the safety and soundness of the National Credit Union Share Insurance Fund (Share Insurance Fund), which insures members' deposits in federally insured credit unions.

Since I last testified before you in May, our country continues to face extraordinary challenges, as the COVID-19 pandemic has affected virtually every facet of American life, wreaking unprecedented economic harm on our nation's citizens and businesses, especially small businesses. The most important response to the pandemic has come, of course, from our health-care workers, who daily put themselves at risk to care for those who are battling this potentially deadly virus. On behalf of the NCUA, I want to express our sincere gratitude to these dedicated professionals, who have been tirelessly serving our nation since the pandemic began.

Our nation's credit union system was well capitalized at the start of the pandemic, with high levels of net worth and ample liquidity. That strength has allowed credit unions to adapt to a myriad of operational challenges resulting from the pandemic and social distancing measures, while still providing needed credit to members, businesses, and communities.

During this same period, the NCUA has worked diligently to provide regulatory relief where possible to give federally insured credit unions the flexibility they need to continue providing financial services to their members. We have adjusted our supervision and examination program to protect the safety of our staff and staffs of the credit unions we oversee, while addressing emerging risks and implementing statutory and regulatory changes that have occurred in response to COVID-19.

## State of the Credit Union System

Credit union performance in the first half of 2020 was influenced by the sudden and steep drop in economic activity that began in the first quarter and accelerated in the second quarter.[2] Despite the challenges, the credit union system performed well and remains well capitalized through our June 2020 reporting.

As of June 30, 2020, there were 5,164 federally insured credit unions, 2.7 percent fewer than a year earlier. This decline in the number of credit unions was due mainly to the long-running

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[1] See NCUA's Mission and Vision, https://www.ncua.gov/about-ncua/mission-values.

[2] The financial performance data presented today are based on the agency's most recent Call Report data, which are for the second quarter of 2020.

trend of consolidation across all depository institutions. During the same period, membership at all federally insured credit unions increased by 3.4 percent, to 122.3 million.

Total assets in federally insured credit unions rose by $229 billion, or 15.1 percent, over the year ending in the second quarter of 2020, to $1.75 trillion. Credit union shares and deposits rose by $210.9 billion, or 16.5 percent, to $1.49 trillion, reflecting the boost in personal income from CARES Act payments to individuals and the sharp economy-wide increase in personal savings. The credit union system's net worth increased by $11.6 billion, or 6.8 percent, over the year to $182.9 billion in the second quarter of 2020. Strong asset growth led to a decline in the aggregate net worth ratio — net worth as a percentage of assets — from 11.27 percent to 10.46 percent. Still, the credit union system remains well capitalized through June 2020.

Credit unions continue to provide needed credit to their members and communities. Total loans outstanding increased to $1.14 trillion in the second quarter of 2020. Credit union loan balances rose in most major categories, including in residential mortgages, auto loans, credit card balances, non-federally guaranteed student loans, and commercial loans.

Federally insured credit unions continued to supply the nation's small businesses and entrepreneurs with needed credit during the pandemic through the Small Business Administration's Paycheck Protection Program (PPP). As of the second quarter, 833 credit unions participated in the PPP and collectively extended 171,000 loans totaling $8.4 billion, with an average loan amount of $49,000. Forty-four of these credit unions were minority depository institutions. Collectively, these MDIs made 6,839 PPP loans totaling $388 million, with an average loan amount $57,000 — helping to ensure minority-owned businesses that have been hardest hit by the COVID-19 pandemic have the support they need to remain open and support their local communities.

The delinquency rate at federally insured credit unions was 58 basis points in the second quarter of 2020, down 5 basis points compared with the second quarter of 2019. Loan performance was mixed across major categories. The net charge-off ratio for all federally insured credit unions was 53 basis points in the second quarter of 2020, compared with 56 basis points in the second quarter of 2019.

The overall liquidity position of federally insured credit unions improved. Cash and short-term investments as a percentage of assets increased from 13 percent to 18 percent, reflecting a 55 percent increase in cash and short-term investments, from $198 billion in the second quarter of 2019 to $308 billion in the second quarter of 2020. Borrowings to shares and net worth declined from 3.6 percent to 3.2 percent over the same period due to the increase in shares.

While economic conditions are improving, the effects of the recent downturn will likely affect credit union performance through the end of the year and into 2021. System-wide delinquency rates, which remained low through the second quarter, could begin to rise as forbearance programs end, particularly given the current high level of unemployment. Interest rates across the maturity spectrum have fallen to historically low levels. A prolonged period of low interest rates also poses risks, particularly to credit unions that rely primarily on investment income. NCUA is actively monitoring economic conditions and assessing these and other risks to credit unions and their members.

### State of the Share Insurance Fund

The Share Insurance Fund reported net income of $20.5 million based on total income of $149.1 million through the second quarter of 2020. The fund reported $17.7 billion in assets as of June 30, 2020.

The equity ratio stands at approximately 1.32 percent.

Through June 30, 2020, there was one federally insured credit union failure that caused a loss to the Share Insurance Fund. Total losses through June 30, 2020 associated with this failure are $1.6 million.

The NCUA's staff have performed multiple scenario analyses of additional share growth and projected losses to determine under what conditions the Share Insurance Fund's equity ratio might fall below the statutory minimum of 1.20 percent. The agency will take all necessary action to ensure the Share Insurance Fund remains strong and retains the public's confidence. While the NCUA remains above the minimum equity ratio for the Share Insurance Fund, vigilance is needed to manage and monitor this situation.

### Implementation of BSA/AML

With each examination it conducts, the NCUA is required by the Federal Credit Union Act to perform a Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) review. And though much has changed in the financial services sector since the act was written in 1979, the agency takes its responsibilities under this law very seriously. Technological advances and the emergence of entrepreneurial financial technology firms are transforming the delivery of financial services, but they are not without risks. Accordingly, BSA laws must adapt in terms of coverage, and they must be flexible to ensure that the United States' BSA/AML regime maintains its integrity.

To that end, the NCUA has worked closely with its sister regulators, U.S. Treasury and law enforcement partners to improve effectiveness and efficiency. This includes active participation in numerous working partnerships, including the BSA Advisory Group, which is led by the Financial Crimes Enforcement Network (FinCEN) and an interagency Principals Working Group. These groups have worked extensively to identify improvements, smart regulations, and industry communications and have prioritized work streams to enhance understanding, effectiveness and efficiency in the BSA/AML system. Some examples include recent policy clarifications for the industry in terms of agency enforcement posture, risk-based nature of our regulatory and supervisory oversight, and clarity on politically exposed persons. The NCUA is committed to ensuring the integrity of the credit unions system and the broader U.S. financial system through smart regulation and policies that will drive more efficient and effective identification of illicit finance.

## Financial Technology and Related Developments

By providing new products and services, increasing the ease and timeliness of product and service delivery, and opening up greater access of a broad range of financial products and services to unbanked and under-banked communities, financial technology ("fintech") is a growing phenomenon that is poised to transform financial services in the United States and around the world. That is why the NCUA, when appropriate, has partnered with its sister agencies to engage in outreach with the industry. For example, the agency has participated in several projects aimed at enhancing service quality and reducing risk. Due to the increased layers between the credit union or bank and the member/customer, however, and insufficient regulatory and supervisory frameworks, the inherent risks of fintech may shift to consumers. Additionally, reduced transparency in payment systems can increase illicit finance risk, and put consumer data privacy in jeopardy. Therefore, while the emergence of fintech presents broad opportunities to empower consumers and small businesses, the regulatory framework must change and adapt so consumers have improved transparency and information, and make informed decisions.

## Executive Compensation Policies for Regulated Entities

Section 956 of the U.S. code requires the NCUA, the federal banking agencies, the Securities and Exchange Commission (SEC), and the Federal Housing Finance Administration (FHFA) to jointly prescribe regulations or guidelines regarding incentive-based compensation practices at covered financial institutions. These regulations or guidelines must prohibit incentive-based compensation arrangements that either encourage inappropriate risks by providing excessive compensation or that could lead to material financial loss to the covered financial institution. The agencies have twice previously published proposed rules to implement Section 956, once in 2011 and again in 2016, and the NCUA is committed to successfully concluding this rulemaking.

## Update on NCUA's COVID-19 Response Since May

The NCUA's response to COVID-19 has been robust. As I noted during my last appearance before this Committee in May, the NCUA mandated on March 16, 2020, a strict offsite examination and supervision policy that continues to this day. Our examination staff continues working closely with credit unions to obtain documentation and complete examination procedures offsite. In doing so, our goal is to limit the burden on credit unions so they can focus on providing uninterrupted service to their members.

Further, as a voting member of the Financial Stability Oversight Council (FSOC), the NCUA plays a key role in identifying and assessing potential risks to the stability of our nation's financial system. Throughout the ongoing COVID-19 pandemic, the Council has maintained a stance of heightened vigilance, marked by an increase in internal deliberations and risk monitoring. Some of the monitored risks are related to, or exacerbated by, the pandemic, but others are less directly connected to the crisis. In recent months, the Council also conducted a comprehensive, activities-based review of the potential risks associated with the secondary mortgage market and the activities of the Government Sponsored Enterprises (GSEs) in particular. That review concluded that any distress at the Enterprises impacting their secondary mortgage activity could pose a risk to financial stability if these risks are not properly mitigated. On behalf of the NCUA, I voted in favor of the findings of this review, which included a pledge to continue to monitor this important segment of the U.S. economy.

Presently, the NCUA does not see any burgeoning risks to the U.S. financial system emanating from the credit union system. Although growing, the credit union industry remains small relative to the overall financial system.

**Revised Supervisory Priorities**

In July, the NCUA issued its updated supervisory priorities to account for the pandemic and its economic disruptions, as well as the various statutory and regulatory changes that have occurred.[3]

Among the agency's new supervisory priorities are reviewing credit unions' good-faith efforts to comply with the CARES Act. The NCUA will also review the actions taken by credit unions to assist borrowers facing financial hardship and the adequacy of credit union loan and lease losses accounts to ensure they can adequately manage the financial and economic disruptions resulting from the pandemic.

For example, these disruptions may result in additional stress on credit union balance sheets, potentially requiring robust liquidity management during the remainder of 2020 and into 2021. As a result, NCUA examiners will continue to assess a credit union's liquidity risk-management practices and planning, and will focus on the effects of loan payment forbearance, loan delinquencies, projected credit losses and loan modifications on credit union liquidity and cash flow forecasting. Additionally, our examiners will analyze the potential effects of low interest rates and the decline of credit quality on the market value of a credit union's assets, funding costs, borrowing capacity, and the adequacy of a credit union's contingency funding plans.

The agency will continue to update its policies and procedures and make enhancements to its supervision program as the pandemic and its economic and financial disruptions evolve.

## CDRLF Grants and Loans to Support Members and Underserved Communities

The Community Development Revolving Loan Fund (CDRLF) program helps low-income-designated credit unions provide basic financial services to their members and stimulate economic activity in their communities.[4] The NCUA uses CDRLF appropriations to make

[3] NCUA Letter to Credit Unions, 20-CU-22, "Update to NCUA's 2020 Supervisory Priorities" available at https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/update-ncuas-2020-supervisory-priorities

[4] A federal credit union with a majority of members qualifying as low-income is eligible for the low-income designation. Low-income members are those members whose family income is 80 percent or less than the median family income for the metropolitan area where they live or national metropolitan area, whichever is greater, or those members who earn 80 percent or less than the total median earnings for individuals for the metropolitan area where they live or national metropolitan area, whichever is greater. See Section 701.34 (a)(1) and (2) of NCUA regulations.

technical assistance grants and to provide low-interest loans to these credit unions, which serve predominantly low-income members.

The COVID-19 pandemic poses unique challenges, both economically and financially, to rural and underserved communities, which are served primarily by small, low-income, and minority credit unions. In April, the NCUA committed the majority of its 2020 CDRLF allocation to COVID-19 assistance. The agency awarded $3.7 million in grants and no-interest loans to 162 low-income credit unions in 40 states and the District of Columbia to help them better serve their members and communities during the pandemic.

There were 153 grants totaling nearly $1.5 million. Of those, 32 went to first-time grant recipients. Forty-eight credit unions were minority depository institutions (MDIs). Grant awards ranged from $900 to $10,000. The agency also approved nine no-interest loans of $250,000 each. The grants and loans fell into four categories:

- Rental, mortgage, and utility payment assistance to members, such as entrepreneurs, small business owners, and hospitality and service industry employees;
- Loan payment relief to affected members;
- New products or services for affected members; and
- Costs associated with moving credit union operations to remote locations, such as laptops, software, and short-term rentals.

The NCUA also awarded more than $960,000 in urgent need grants to 148 eligible credit unions in 42 states and the District of Columbia. Sixteen of these recipients were MDIs. Urgent need grant awards ranged from $1,600 to $7,500. Of these, 144 grants, totaling more than $930,000, were to assist with credit unions' needs resulting from the COVID-19 pandemic, including:

- Hardware, software, and other equipment to help credit unions provide financial products and services from remote locations;
- Marketing materials to keep members informed and assure them their insured deposits are safe; and
- Consulting services to develop programs and partnerships to assist small businesses and schools.

Four urgent need grants, totaling $30,000, were made to repair damage to credit unions from a natural disaster not covered by insurance and to replace necessary equipment to immediately restore services to members because of unexpected events.

The NCUA awarded $75,000 in grants to three low-income, MDI credit unions to support mentoring programs with larger credit unions. This mentoring program helps small, low-income MDIs establish mentoring relationships with larger low-income credit unions to provide expertise and guidance in serving low-income and underserved populations. The larger credit unions will offer technical assistance, such as building staff capacity through training and improvements to credit union operations.

## Community Reinvestment Act (CRA)

The Community Reinvestment Act (CRA), which was enacted by Congress in 1977 to end the system of banks engaging in redlining, and encourage banks and thrift institutions to "*serve the convenience and needs of the communities in which they are chartered to do business*," does not apply to credit unions, since they exist to serve the credit needs of individuals of modest means. Indeed, the American credit union movement began as a cooperative effort to serve the credit needs of individuals of modest means and credit unions today continue to fulfill this public purpose.

## Merger Activity

Across a variety of economic cycles and regulatory environments, the number of credit unions has fallen at a steady rate for nearly three decades.

A number of factors are contributing to this decline. First, economies of scale and consumer demand for more services have led to mergers, reducing the number of active depository institutions. Second, new marketplace competitors are expanding into areas that credit unions have traditionally operated by providing deposit-like products, such as prepaid cards, and alternative lending products, such as crowdsourcing, peer-to-peer lending and small business financing. Third, consumers are increasingly using electronic and mobile devices for their financial needs, meaning that credit unions that lack the resources necessary to acquire new technology and develop new products and services face enormous challenges.

Together, these trends indicate that credit unions will face increased competition and the longstanding consolidation trend will likely continue. The majority of merging credit unions are comprised of smaller credit unions, and the most common reason for merging is to expand services, as larger credit unions tend to offer more complex products and services to their members. However, we have seen a growing number of larger credit unions use mergers and acquisitions as strategies to grow and increase market share.

Due to the pandemic, merger activity for federally insured credit unions has slowed, but may increase as conditions evolve. The NCUA will monitor these trends to ensure the continued consolidation of credit unions and system assets does not create new potential risks to the Share Insurance Fund.

Compared with the volume of bank-to-bank mergers and credit-union-to-credit-union mergers, the number of credit unions' purchasing banks is very small. Of the 36 NCUA-approved bank purchases by federally insured credit unions since 2012, 13 were banks with assets less than $100 million. Another 16 of the transactions involved banks with assets from $100 million to $250 million. Only seven of the approved transactions were banks with assets above $250 million.

The NCUA does not prohibit the transactions because credit unions are permitted by regulation to purchase banks. Additionally, bank-to-credit union transactions must also be approved by the

Federal Deposit Insurance Corporation, per the Bank Merger Act, and the state credit union regulatory agency, as applicable for transactions involving a state-chartered credit union.

The NCUA has regulations to oversee the sale of a credit union to a bank. These regulations ensure the members' equity is properly valued by an independent third party who establishes a market valuation of the credit union. The purchasing bank must pay the credit union at least that amount thereby ensuring the selling members are paid a fair value for their equity.

## Working with Borrowers Affected by COVID-19

The credit union industry has a long history of assisting its member-owners in times of need, and we have encouraged credit unions to work with affected members. For example, a credit union may work with a borrower to extend the terms of repayment or otherwise restructure the borrower's debt obligations. Such efforts can ease pressures on troubled borrowers, improve their capacities to service debt, and strengthen a credit union's ability to collect on its loans. Credit unions may also ease terms for new loans to affected borrowers when prudent. This may help consumer and business members deal with any impact on their cash flows due to COVID-19.

I want to assure you that the NCUA's examiners will not criticize a credit union's efforts to provide prudent relief for members when such efforts are conducted in a reasonable manner with proper controls and management oversight.

## Central Liquidity Facility

Following the regulatory enhancements provided by the CARES Act and changes to the agency's regulations, the Central Liquidity Facility (CLF) experienced a significant increase in its membership and borrowing capacity.

The CLF is a mixed-ownership government corporation that provides the credit union system with a contingent source of funds to assist credit unions experiencing unusual or unexpected liquidity shortfalls during individual or system-wide liquidity events. The CLF also serves as an additional liquidity source for the Share Insurance Fund, which helps to ensure the credit union system and the fund remain strong. Member credit unions own the CLF, which is managed by the NCUA. Joining the facility is voluntary.

As of October 9, 2020, the number of regular members of the CLF, which consists of natural-person credit unions, was 340, up from 283 members in April. All 11 corporate credit unions became agent members in May, meaning most of their member credit unions now also have access to CLF loans. In total, 4,145 credit unions, or 80 percent of all federally insured credit unions, have access to the CLF, either as a regular member or through their corporate credit union.

New memberships have added $989.8 million in additional subscribed capital stock to the facility. Under the temporary authority granted by the CARES Act, the CLF can borrow sixteen times its total capital. As of October 9, the facility's borrowing authority stood at $32.2 billion, an increase of $21.7 billion since April. The NCUA encourages all credit unions to consider joining the CLF to bolster the system's access to emergency liquidity, should the need arise.

## Rulemakings since May 2020

My goal is to create a regulatory environment that allows for innovation and flexibility, creates new avenues for growth, and accounts for the constantly evolving economic, competitive, and regulatory environment. In addition, the NCUA Board continues to prioritize regulatory relief measures that will help credit unions through this pandemic.

I would like to highlight our most significant rulemakings and actions since my appearance before this committee in May. Additional information about the Board's regulatory actions can be found on the NCUA's public website.

**NCUA's Prompt Corrective Action Rules**
The NCUA Board unanimously approved an interim final rule that makes two temporary changes to the agency's prompt corrective action regulations to provide relief to credit unions that temporarily fall below the well-capitalized level. This interim rule temporarily waives the earnings retention requirement for credit unions classified as adequately capitalized. Those credit unions unable to meet the earnings retention requirement will not have to submit a written application requesting approval to decrease their earnings retention amount. If a credit union poses an undue risk to the Share Insurance Fund or exhibits material safety and soundness concerns, the appropriate NCUA Regional Director may require the credit union to submit an earnings transfer waiver request.

By statute, credit unions that fall to less than adequately capitalized must submit a net worth restoration plan to their NCUA Regional Director. The interim final rule temporarily permits an undercapitalized credit union to submit a streamlined net worth restoration plan when the reduction in the net worth ratio was caused predominantly by share growth and is a temporary condition because of the pandemic. If a credit union becomes less than adequately capitalized for reasons other than share growth, it must still submit a full net worth restoration plan under the current requirements in NCUA's regulations. These temporary modifications will remain in place until December 31, 2020.

**NCUA's Chartering and Field-of-Membership Regulations**
The NCUA Board unanimously approved a final rule that would allow greater access to safe and affordable financial services by changing the agency's chartering and field-of-membership regulations for community charter approvals, expansions, or conversions.

The final rule re-adopts a provision to allow a credit union applicant to designate a combined statistical area, or an individual, contiguous portion thereof, as a well-defined local community if the chosen area has a population of 2.5 million or fewer. The rule also clarifies existing requirements and adds an explicit provision to the NCUA's field-of-membership regulations to address concerns about potential discrimination in the selection process for combined statistical areas and core-based statistical areas.

The rule became effective on October 14, 2020.

**NCUA's Prompt Corrective Action Rule in Response to CECL**

The NCUA Board unanimously approved a proposed rule that would phase-in the day-one adverse effects on regulatory capital that may result from the current expected credit losses (CECL) accounting methodology. This proposal is consistent with regulations issued by the federal banking agencies.

Under the proposed rule, the NCUA Board would phase-in the day-one effects on a federally insured credit union's net worth ratio over a three-year period under the NCUA's prompt corrective action regulations. The proposed rule would temporarily mitigate the adverse consequences of the day-one capital adjustments, while requiring that credit unions account for CECL for other purposes, such as on their Call Reports.

The phase-in would be applied to only those federally insured credit unions that adopt the CECL for the fiscal years beginning on or after December 15, 2022, which is the deadline established by the Federal Accounting Standards Board. Credit unions that decide to adopt CECL for the fiscal years beginning before that date would not be eligible for the phase-in.

Under the proposal, federally insured credit unions with less than $10 million in assets would no longer be required to determine their charges for loan losses under GAAP. Instead, these credit unions could use any reasonable reserve methodology if it adequately covers known and probable loan losses.

The comment period for this proposed rule closed on October 19, 2020. The NCUA is reviewing the comments before finalizing the rule.

**NCUA's Derivatives Regulations**

The NCUA Board approved a proposed rule that amends the agency's derivatives rule in Subpart B to Part 703 to allow more flexibility for federal credit unions to manage their interest rate risk through these financial instruments. The proposed changes include eliminating the preapproval process for federal credit unions that are complex with a Management CAMEL component rating of 1 or 2, the specific product permissibility, and the regulatory limits on the amount of derivatives a federal credit union may purchase.

The comment period for this proposed rule is currently open.

## Cybersecurity Efforts in Response to COVID-19

The COVID-19 pandemic has prompted a heightened cybersecurity stance on the part of both the agency and industry, with an emphasis on credit union service continuity, remote workers' security and compliance, and flexibility regarding internal agency supervision and examination operations. Like others in the financial services sector, the NCUA has seen increasing fraudulent activity, such as phishing, identity theft, and credential acquisition; ransomware; and cyber-enabled fraud methods. In August, drawing on partnerships with the Department of Treasury, Department of Homeland Security, Secret Service, and the Federal Bureau of Investigation

(FBI), the agency issued a guidance letter informing credit unions about the risk of fraud associated with the COVID-19 pandemic. The NCUA continues to monitor developments in these areas.

## Diversity, Equity, and Inclusion

I am proud to lead an agency where its core values embrace the tenets of diversity, equity, and inclusion (DEI). As foundational elements of who we are and how we operate as an agency, the principles of diversity and inclusion are strategic imperatives for the NCUA. Indeed, the NCUA believes a diverse workforce, an inclusive work environment, and a diverse supply chain make good business sense, and the agency is equally committed to all three areas.

Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act has been a catalyst for growth and change in the diversity and inclusion space at the NCUA. We are proud of the progress we have made over the last decade, but this vital work is ongoing and takes long-term dedication and commitment.

Our investment in this vein is already paying dividends in the form of improvements in diversity within our leadership pipeline. For example, over the past five years, racial and ethnic diversity in our management-level staff, those in grades 13 through 15, has increased by more than five percent. During the same period, racial and ethnic diversity among our senior staff positions has increased by almost 12 percent.

More than 20 percent of the NCUA's workforce belongs to one of our six employee resource groups, which support our diverse employees and create a strong sense of belonging within the agency. We also repurposed our diversity council to create a Culture, Diversity, and Inclusion Council to examine our organizational culture and make needed changes to create a more inclusive work environment.

The NCUA has also been a leader in supplier diversity. For the past two years, the agency awarded more than 40 percent of our total contract dollars to minority- or women-owned businesses.

More broadly, within the credit union system, the NCUA is committed to promoting diversity, equity, and inclusion. In my May testimony, for example, I noted that the NCUA hosted its first annual DEI Summit in late 2019. This summit was a first-of-its-kind event in the credit union industry and attracted more than 150 attendees. Following that event, interest in diversity, equity, and inclusion in the credit union system has grown significantly. In fact, several industry leaders came together with the NCUA and formed the Credit Union DEI Collective, which serves as a resource to the industry on all things related to DEI.

Following the event, the NCUA saw a significant uptick, especially from larger credit unions, in the number of voluntary Credit Union Diversity Self-Assessments submitted in 2019. Though the volume received is still low, and we remain dissatisfied with the credit union industry's response levels, we have seen steady increases in submissions every year. To address this, the NCUA Board voted unanimously at its July meeting to seek comment from credit unions on potential ways to incentivize submissions of the diversity assessments. For example, the NCUA is considering the viability of reducing the operating fees charged to credit unions that submit assessments. We hope this Committee would support the agency in this effort.

Another way that the NCUA is supporting diversity, equity and inclusion is through its internship programs, which provide valuable work experience for high school undergraduate, graduate, law, and Ph.D. students who are considering careers in economics, finance, accounting, information technology, law, and human resources.

Among these programs is the NCUA's High School Scholars Internship Program, which provides high school students from the most economically disadvantaged areas of Washington D.C. to earn a salary of $20 per hour, $20 per day special compensation benefits for lunch, and a $650 professional attire clothing allowance. High school interns are also gifted with a laptop, which they can keep at the end of the internship.

Similarly, the NCUA's Pathways Summer Intern Program enables summer college interns to receive an hourly salary ranging from $18.80 to $20.68 per hour, depending on the grade level at which they were hired. The interns earn annual and sick leave at a rate of four hours per pay period, and are reimbursed for internet service charges at a rate of $50 per month. The NCUA also has six individual multi-year contracts with minority-serving organizations to provide summer internships and opportunities to college and university students in undergraduate, graduate, doctorate, and juris doctorate programs.

## ACCESS Initiative

During my tenure as Chairman, I have consistently characterized financial inclusion as the civil rights issue of our era. Fundamentally, financial inclusion means expanding access to safe and affordable financial services for unbanked and underserved people and communities as well as broadening employment and business opportunities. Whether it's the challenges faced by African American, Latino or Native American working families; the obstacles that military veterans or disabled Americans must overcome; or the stress that communities throughout rural America face due to their lack of capital, we must do more to make safe and affordable financial services and products available to our fellow citizens. There is also a clear business case for credit unions to increase outreach to underserved populations. Accordingly, I have directed the NCUA to identify ways to bring more Americans into the financial mainstream.

To that end, the agency launched in October a new initiative called ACCESS, or **A**dvancing **C**ommunities through **C**redit, **E**ducation, **S**tability & **S**upport. Comprised of representatives from across the agency, this initiative will refresh and modernize regulations, policies, and programs that support financial inclusion within the agency and, more broadly, throughout the credit union system. By dedicating resources from across its business units, the NCUA will work to ensure an inclusive and open-minded approach to making access to safe and affordable financial services more widely available.

It is fitting that the NCUA play a driving role in these efforts, as credit unions have a strong emphasis on service to their members and to the surrounding community. Those qualities are captured in the credit union's "people helping people" ethos, which is exactly the mindset we need in the coming recovery.

## Legislative Requests

The CARES Act contained several provisions that provided the NCUA with additional measures to ensure the continued stability and liquidity of the credit unions system as it responded to the COVID-19 pandemic. However, these provisions are set to expire on December 31, 2020. We ask that Congress extend the authority it granted the NCUA in the CARES Act for the length of the pandemic. This is especially true for the statutory changes that provided the Central Liquidity Facility with increased flexibility and borrowing authority to support the liquidity needs of the system and the Share Insurance Fund.[5]

Before the CARES Act was enacted into law, the CLF had the authority to borrow provided its obligations do not exceed twelve times the subscribed capital stock and surplus of the CLF (that is, the sum of its retained earnings and capital stock).[6] The CARES Act temporarily increased the multiplier from 12 to 16, meaning that, for every $1 of capital and surplus, the CLF can now borrow $16. Because a credit union that joins the CLF pays in only half of the subscribed capital stock subscription amount, the CLF can now borrow, $32 for each new dollar of paid in capital it raises. [7]

Second, the CARES Act temporarily relaxes the requirements on agent membership, making such membership more affordable for corporate credit unions.[8] An agent member is no longer required to buy capital stock for all of its member credit unions, but may buy CLF capital stock for a chosen subset of the credit unions it serves.[9]

Third, the CARES Act changed the definition of "liquidity needs" to include the needs of any credit union, not only natural-person credit unions.[10] This new definition broadens access by allowing the CLF to meet the liquidity needs of corporate credit unions.

Lastly, the CARES Act provides more clarity about the purposes for which the NCUA Board can approve liquidity-need requests by removing the phrase "the Board shall not approve an application for credit the intent of which is to expand credit union portfolios."[11] The NCUA Board now has more flexibility and discretion to approve applications for CLF members that

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[5] The CLF borrows from the U.S. Treasury's Federal Financing Bank to make loans to member credit unions and the Share Insurance Fund.
[6] See 12 U.S.C. § 1795f(a)(4)(A)
[7] Credit unions must subscribe to the CLF capital stock in the amount of one-half of one percent of the credit union's six-month average of paid-in and unimpaired capital and surplus (that is, the total of shares and deposits and undivided earnings). Credit unions only have to remit to the CLF one-half of the subscription amount (one-quarter of one-percent of paid-in and unimpaired capital and surplus), and hold the remaining half (which is callable by the NCUA Board).
[8] A credit union or group of credit unions that primarily serve other credit unions may become an agent member by meeting certain requirements outlined in 12 U.S.C. § 1795c(b).
[9] See 12 U.S.C. § 1795c(b)(2)
[10] See 12 U.S.C. § 1795a(1)
[11] See 12 U.S.C. § 1795e(a)(1)

have made a reasonable effort to first utilize primary sources of funding. This change increases the transparency and efficiency of the loan-approval process by removing doubt about whether a credit union's portfolio may expand if it borrows from the CLF to meet liquidity needs.

As I noted earlier in my testimony, the NCUA has successfully encouraged natural-person and corporate credit unions to join the facility. New memberships have added $989.8 million in additional subscribed capital stock to the facility since April. Under the temporary authority granted by the CARES Act, the facility's borrowing authority, as of October, stood at $32.2 billion, an increase of $21.7 billion since April. In total, 4,145 credit unions, or 80 percent of all federally insured credit unions, now have access to the CLF, either as a regular member or through their corporate credit union.

The growth in the number of CLF's members and its borrowing authority is a testament to our nation's credit unions coming together in a time of crisis to strengthen the national system of cooperative credit. The COVID-19 pandemic has caused severe economic and financial distributions, and it is likely these disruptions will continue in to 2021.

As such, I respectfully request that these changes be extended for the pandemic's duration. This extension would provide regulatory certainty to credit unions. Having a reinforced CLF will also ensure the credit union system can continue to support its members and communities should the need for emergency liquidity arise.

## Conclusion

Chairwoman Waters, Ranking Member McHenry, and Members of the Committee, we appreciate your continued support of the credit union system, as well as the goals, priorities, initiatives, and employees of the NCUA.

While we have seen signs of improvement in the overall economy, the NCUA recognizes that the challenges before us are far from over. We remain steadfast in our mission of maintaining the safety and soundness of the credit unions system and protecting the deposits of the millions of Americans who rely on credit unions for their financial needs. We will not waiver from that responsibility.

We look forward to working with all of you to ensure we are putting forth our best efforts to protect our nation's federally insured credit union system and our nation's system of cooperative credit.

Thank you.

**STATEMENT OF**

**JELENA MCWILLIAMS**
**CHAIRMAN**
**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

**OVERSIGHT OF PRUDENTIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, DIVERSITY, AND ACCOUNTABILITY OF DEPOSITORY INSTITUTIONS DURING THE PANDEMIC**

**before the**

**COMMITTEE ON FINANCIAL SERVICES**
**U.S. HOUSE OF REPRESENTATIVES**

**November 12, 2020**

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for the opportunity to testify today before the House Financial Services Committee.

When I appeared before this Committee six months ago, we were confronting great uncertainty and volatility due to the COVID-19 pandemic. Many industries and segments of the economy were experiencing unprecedented declines in activity, and this shock was reverberating throughout the financial system.

Although there remains considerable uncertainty about the path of the economy, we know from two quarters of industry-wide reporting that the banking system has served as a source of strength throughout this period. Notwithstanding declines in aggregate earnings, during the first half of the year banks of all sizes supported their customers and communities, including by originating the vast majority of over $500 billion in Small Business Administration-guaranteed Paycheck Protection Program (PPP) loans.[1]

The banking system's ability to support the economy reflects the industry's strong capital and liquidity positions. In the second quarter of 2020, aggregate equity capital increased to more than $2.1 trillion, which translated to an average common equity tier 1 capital ratio of 13.4 percent.[2] On both an aggregate and percentage basis, these capital levels were slightly higher than the quarter immediately preceding the pandemic.

In addition, the banking system has accommodated two consecutive quarters of over $1 trillion in new deposits, customer demand that far exceeds any deposit growth the FDIC has seen in the past.[3] These inflows demonstrate public confidence in the banking system, as individuals and businesses sought safety during the uncertain economic environment.[4]

To support the ability of banks to work constructively with their customers, the Federal Deposit Insurance Corporation (FDIC) has taken meaningful actions to provide banks necessary flexibility while maintaining safety and soundness.

Today, I will provide an update on five areas in which we have made significant progress:

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[1] *See* SBA, Paycheck Protection Program (PPP) Report, available at https://www.sba.gov/sites/default/files/2020-08/PPP_Report%20-%202020-08-10-508.pdf.

[2] *See* FDIC, Quarterly Banking Profile, Second Quarter 2020, available at https://www.fdic.gov/bank/analytical/qbp/2020jun/qbp.pdf.

[3] *See id.* at 4.

[4] This growth has been so rapid and substantial that, despite a $1.4 billion increase in the Deposit Insurance Fund (DIF) during the second quarter of 2020 – resulting in a record balance of $114.7 billion – the DIF reserve ratio fell from 1.39 percent in the first quarter to 1.30 percent, which is below the required minimum level of 1.35 percent. This reduction was solely a result of the unprecedented increase in bank deposits, and we believe deposit growth is likely to normalize in the upcoming quarters and that the reserve ratio will rise above 1.35 percent without any need to modify assessment rates in the near-term. *See* Federal Deposit Insurance Corporation Restoration Plan, 85 Fed. Reg. 59306 (Sept. 21, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-09-21/pdf/2020-20690.pdf ("...it is the FDIC's view that raising assessments based on two quarters of extraordinary insured deposit growth would be premature.").

- Responding to economic risks related to COVID-19;
- Enhancing resolution readiness;
- Supporting communities in need;
- Fostering technology solutions and encouraging innovation; and
- Finalizing outstanding rulemakings.

I appreciate the opportunity to update the Committee on each of these key issues.

## I. Responding to Economic Risks Related to COVID-19

Beginning in early March, the FDIC and our fellow regulators undertook a series of actions that helped maintain stability in financial markets. Specifically, we (1) encouraged banks to use their capital and liquidity buffers to lend and provide other critical financial services, (2) made targeted, temporary regulatory changes to facilitate lending and other financial intermediation, (3) provided needed flexibility for banks to work with their borrowers and modify loans when appropriate, and (4) fostered small business lending by facilitating the use of new government programs, including the PPP.[5]

*Regulation*

Over the past six months, the FDIC has taken additional regulatory actions in support of these objectives. For example, we issued a final rule to mitigate the deposit insurance assessment effect of participating in the PPP and the PPP lending facility, as well as the Money Market Mutual Fund Liquidity Facility.[6]

In addition, the FDIC, Federal Reserve Board (FRB), and the Office of the Comptroller of the Currency (OCC) issued an interim final rule providing insured depository institutions (IDIs) subject to the supplementary leverage ratio (SLR) the ability to elect to temporarily exclude deposits at Federal Reserve Banks and U.S. Treasuries from total leverage exposure.[7] Absent these adjustments, the increase in IDIs' balance sheets may cause a sudden and significant spike in regulatory capital needed to meet the SLR requirements. This adjustment, which will remain in effect through March 31, 2021 for banks that make the election, will support the ability of IDIs to accommodate customer deposit inflows and serve as financial intermediaries in the U.S. Treasury market without incentivizing banks to take on additional risk.

Last month, we issued an interim final rule that would allow IDIs that have experienced growth to determine whether they are subject to the requirements of Part 363 of the FDIC's regulations (*i.e.*, Annual Independent Audits and Reporting Requirements) for fiscal years

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[5] For a more detailed description of these actions, see FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (May 12, 2020), available at https://www.fdic.gov/news/speeches/spmay1220.html.
[6] *See* Assessments, Mitigating the Deposit Insurance Assessment Effect of Participating in the Paycheck Protection Program (PPP), the PPP Liquidity Facility, and the Money Market Mutual Fund Liquidity Facility, 85 Fed. Reg. 38282 (June 26, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-06-26/pdf/2020-13751.pdf.
[7] *See* Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio for Depositor Institutions, 85 Fed. Reg. 32980 (June 1, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-06-01/pdf/2020-10962.pdf.

ending in 2021 based on their consolidated assets as of December 31, 2019.[8] Such IDIs, whose asset growth may be temporary but significant, would otherwise be required to develop processes and systems to comply with these requirements on a potentially short-term basis. The FDIC is also actively considering similar targeted adjustments to further mitigate unintended consequences resulting from pandemic-related government programs.

*Supervision*

Along with targeted regulatory changes, we have also taken supervisory actions intended to increase flexibility for banks to meet customer needs. In March, we encouraged banks to work with all borrowers, especially those from industry sectors particularly vulnerable to economic volatility, and we clarified that prudent efforts to modify the terms on existing loans for affected customers will not be subject to examiner criticism.[9]

In June, the FDIC, FRB, OCC, and National Credit Union Administration – in conjunction with the state banking regulators – issued examiner guidance to outline the supervisory principles for assessing the safety and soundness of institutions given the ongoing impact of the pandemic.[10] Notably, the guidance states that examiners will consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise appropriate flexibility in their supervisory response.

In addition, we provided additional information regarding loan modifications, including by confirming with the staff of the Financial Accounting Standards Board that short-term modifications (e.g., six months) made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not troubled debt restructurings (TDRs) under ASC Subtopic 310-40.[11] In conjunction with the other members of the Federal Financial Institutions Examination Council (FFIEC), we issued further guidance on additional loan accommodations related to COVID-19, which discusses loan modifications and TDRs in greater detail. We continue to monitor conditions and receive feedback from supervised institutions, and we will consider additional guidance as appropriate.

*PPP*

Before I conclude my remarks on the FDIC's response to the COVID-19 pandemic, I would like to offer a few high-level observations regarding the PPP. This program highlighted

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[8] *See* The FDIC Approves Interim Final Rule to Provide Temporary Relief from Part 363 Audit and Reporting Requirements (Oct. 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20114.html.

[9] *See* FDIC, FIL-17-2020, *Regulatory Relief: Working with Customers Affected by the Coronavirus* (Mar. 13, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20017.html.

[10] *See* FDIC, FIL-64-2020, *Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions* (June 23, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20064.html.

[11] *See* FDIC, FIL-36-2020, *Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus* (Apr. 7, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20036.html; *see also* FDIC-FIL-22-2020, *Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus* (Mar. 22, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html.

the vital role of community banks in supporting small businesses through commercial and industrial (C&I) lending. We know that the overwhelming majority of community banks focus their C&I lending on small businesses and often have key advantages in flexibility and the speed with which they can deliver funding.[12]

These attributes, as well as strong ties to their borrowers and communities, likely explain why community banks have played an outsized role in the PPP. As of the second quarter of 2020, community banks held approximately $148 billion, or 31 percent of all PPP loans – a significant share relative to the 15 percent of total industry loans and 13 percent of total C&I loans. Overall, all banks held approximately $482 billion in PPP loans, or 92 percent of total PPP loans made.

To further highlight their important role during the pandemic, community banks experienced a growth rate of 13.5 percent for total loans and 63 percent for C&I loans in the second quarter of 2020. These rates contrast with the broader banking industry, which experienced a growth rate of 0.6 percent for total loans and 5.9 percent for C&I loans during the same period. With respect to PPP lending, we can certainly see that community banks have had an outsized impact on their customers and communities. The FDIC took a number of steps to provide information to banks and facilitate their ability to make loans to small business under the program.

## II. Enhancing Resolution Readiness

As the FDIC responded to the immediate impact of the COVID-19 pandemic through these targeted regulatory and supervisory actions, we also focused on enhancing our resolution readiness in several ways.

Although we entered the pandemic with a historically low number of bank failures – the four failures in 2019 were the first since December 2017 – we recognized that the absence of failures could not last forever.[13] Accordingly, even before the onset of the pandemic, the FDIC has taken steps to improve our resolution-related capabilities.[14]

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[12] *See* FDIC, 2018 Small Business Lending Survey, available at https://www.fdic.gov/bank/historical/sbls/full-survey.pdf.

[13] *See, e.g.*, FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (Dec. 5, 2019), available at https://www.fdic.gov/news/news/speeches/spdec0519.html ("This expansion and consequent absence of failures cannot endure forever. It is normal – and indeed expected – for some banks to fail, and our job at the FDIC is to protect depositors and ensure that banks can fail in an orderly manner.").

[14] On March 5, 2020, the FDIC announced that it will offer voluntary retirement and early separation opportunities to approximately 20 percent of its employees to help reshape the agency's workforce for the future and to enhance preparedness. As of July 31, 2019, 42 percent of the FDIC's workforce is eligible to retire within the next five years, which could deplete the FDIC's institutional experience and knowledge, especially during a crisis. This plan was intended to address that risk. Due to the COVID-19 pandemic, however, we put this plan on hold.

*Preparedness and Coordination*

Our ability to fulfill our mission depends on having an experienced, knowledgeable, and agile workforce. Notwithstanding recent changes that have increased workforce preparedness, we are committed to continuous improvement.

Last year, we announced the centralization of our supervision and resolution activities for banks with more than $100 billion in total assets for which the FDIC is not the primary regulator.[15] This move is more than just an organizational realignment. Rather, combining these key functions has created a stronger, more coherent approach for bank resolution and supervision by enabling us to take a more holistic approach. Following this change, we have experienced organizational synergies that enable us to more efficiently pull together market-based, institution-based, and resolution-based perspectives. This alignment has helped to ensure that information, resources, and expertise are shared in advance and readily available in the event of a crisis.

In response to economic risks related to COVID-19, the FDIC established a new approach to bank closing activities to include appointing a health and safety officer, obtaining and using cleaning supplies and protective personal equipment, establishing a smaller on-site closing team supplemented by a remote team, employing greater use of technology, and modifying travel plans for attending the closing. The FDIC has successfully executed three resolutions using these techniques at institutions that failed since March due to enduring financial challenges unrelated to COVID-19.[16] Lessons learned from these resolutions are being incorporated into plans for any future supervisory or resolution activities that may be required on-site at financial institutions during the pandemic.

On March 16, 2020, the FDIC instituted mandatory telework and moved all supervisory activities offsite to protect the health and safety of employees and to provide flexibility to institutions responding to operational challenges brought on by the pandemic. Working with its financial institutions, the FDIC has maintained its supervisory programs for both safety and soundness and consumer protection and is on track to meet all associated statutory requirements and internal goals.[17] The majority of institutions have not had difficulty with the FDIC continuing supervisory activities, and only a small number have asked for brief delays due to pandemic-related operational challenges at the institution or on-site document access limitations.

[15] *See* FDIC to Centralize Key Aspects of Its Large, Complex Financial Institution Activities (June 27, 2019), available at https://www.fdic.gov/news/press-releases/2019/pr19056.html.
[16] *See, e.g.*, MVB Bank, Inc. of Fairmont, West Virginia, Acquires The First State Bank, Barboursville, West Virginia (Apr. 3, 2020), available at https://www.fdic.gov/news/news/press/2020/pr20046.html.
[17] *See* section 10(d) of the Federal Deposit Insurance Act (12 U.S.C. 1820(d)) as implemented by section 337.12 of the FDIC's Rules and Regulations. Since March 16 (and through November 1), the FDIC has started and finalized 829 safety and soundness examinations, 843 Bank Secrecy Act examinations, 819 information technology examinations, 174 trust examinations, 4 registered transfer agent examinations, 520 examinations for consumer compliance along with an evaluation of performance under the Community Reinvestment Act, 139 examinations for consumer compliance only, and an additional 4 evaluations of performance under the Community Reinvestment Act alone.

The FDIC has conducted heightened monitoring of financial institutions whose activities or concentrations may present additional concerns due to the economic consequences of the pandemic. We have expanded our regular risk monitoring activities, particularly for institutions that have concentrated exposures to the industries that have been most impacted by the pandemic. Various division across the FDIC coordinate to bring together institution-specific and macroeconomic information, including assessments of aggregate banking industry vulnerabilities to credit and liquidity risk.

The FDIC also continues its coordination with our international counterparts – including those in the European Union, United Kingdom, and Switzerland – on cross-border resolution for global systemically important banks (GSIBs).[18] These longstanding relationships allowed us to maximize coordination during the onset of economic and financial market volatility related to the pandemic. We will continue to build plans, test scenarios, and improve capabilities in order to enhance our collective resolution readiness.

To further develop our perspectives on issues related to the resolution of systemically important financial institutions, the FDIC recently hosted a meeting of our Systemic Resolution Advisory Committee (SRAC) to discuss and receive updates on resolution planning under bankruptcy and resolution planning under the Orderly Liquidation Authority.[19] The FDIC will continue to foster dialogue on emerging resolution-related issues through this platform.

*Targeted Engagement*

In addition to the resolution plans submitted pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the FDIC has a rule requiring resolution plans for certain IDIs with more than $50 billion in total assets. In November 2018, we announced that the FDIC would revise this rule and that the next round of IDI plans would not be required until this rulemaking process has been completed.[20] In April 2019, the FDIC issued an advance notice of proposed rulemaking (ANPR) seeking comment on potential changes to the agency's approach to IDI plans.[21] The FDIC has reviewed the comment letters on the ANPR and intends to issue a proposed rule on IDI plans.

Resolution planning remains critical for the FDIC and large banks. Although the FDIC is not requiring IDI plans during the pendency of the rulemaking process, we have begun carrying out targeted engagement and capabilities testing with select firms on an as-needed basis. This

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[18] *See, e.g.,* FDIC Chairman Jelena McWilliams, "Resolution Readiness: Adapting to our Uncertain World," speech before the Single Resolution Board Annual Conference (Oct. 8, 2020), available at https://www.fdic.gov/news/speeches/spoct0820.html.

*See, e.g.,* FDIC Chairman Jelena McWilliams, "Resolution Readiness: Adapting to our Uncertain World," speech before the Single Resolution Board Annual Conference (Oct. 8, 2020), available at https://www.fdic.gov/news/speeches/spoct0820.html.

[20] *See* FDIC Chairman Jelena McWilliams, "Keynote Remarks," speech before the 2018 Annual Conference of The Clearing House (TCH) and Bank Policy Institute (BPI) (Nov. 28, 2018), available at https://www.fdic.gov/news/speeches/spnov2818.html.

[21] *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 84 Fed. Reg. 16620 (Apr. 22, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-04-22/pdf/2019-08077.pdf.

approach is consistent with both the requirements of the FDIC's existing IDI plan rule[22] and the approach envisioned under the ANPR, which shifts emphasis toward engagement and capabilities testing.

*Rulemaking*

Earlier this year, the FDIC finalized two rules that will improve our resolution-related activities. Last month, we finalized a rule to reduce interconnectedness within the financial system and limit the potential for financial sector contagion in the event of the failure of a GSIB.[23] The rule generally requires advanced approaches banking organizations to deduct from regulatory capital the amount of any investment in, or exposure to, total loss-absorbing capacity (TLAC) or long-term debt (LTD) issued by a GSIB that was not already subject to deduction. The single point of entry resolution strategy for resolving U.S. GSIBs relies on investors that hold TLAC and LTD to absorb losses at the point of resolution. By limiting the exposure of large institutions to TLAC and LTD, this rule helps reduce contagion and works with other reforms that enhance the FDIC's ability to resolve a U.S. GSIB.

Earlier this year, we issued a Dodd-Frank Act-mandated final rule, in conjunction with the Securities and Exchange Commission (SEC), to clarify and implement provisions of the statute relating to the orderly liquidation of certain brokers or dealers in the event the FDIC is appointed receiver.[24] Among other things, the rule clarifies how the relevant provisions of the Securities Investor Protection Act of 1970 would be incorporated into a Title II resolution proceeding. Although the FDIC and SEC have acknowledged the limited circumstances in which the rule would be applied, the clarifications provided by the final rule will prove valuable should a broker-dealer be subject to a Title II orderly liquidation.

## III. Supporting Communities in Need

As the COVID-19 pandemic continues to disrupt the daily lives of all Americans, we are particularly mindful that minority and low- and moderate-income (LMI) communities have suffered disproportionately, from both a health and economic perspectives. As the nation's deposit insurer and primary supervisor of community banks, including minority depository institutions (MDIs), the FDIC plays an important role in helping these institutions meet the needs of their customers and communities.[25]

[22] *See* 12 CFR § 360.10(d).
[23] *See* Agencies Finalize Rule to Reduce the Impact of Large Bank Failures (Oct. 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20115.html.
[24] *See* Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 85 Fed. Reg. 53645 (Aug. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-08-31/pdf/2020-16468.pdf.
[25] Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 sets forth several statutory goals for the FDIC and other financial regulators, including: (1) preserve the number of MDIs; (2) preserve the minority character in cases involving merger or acquisition of an MDI; (3) provide technical assistance to prevent insolvency of institutions not now insolvent; (4) promote and encourage creation of new MDIs; and (5) provide for training, technical assistance, and educational programs.

A significant part of my focus as FDIC Chairman has been bridging the gap between those that belong and those that do not. The need to create a financial system of inclusion and belonging is not theoretical or merely academic to me; it is personal.

We know that individuals from LMI communities are often the least likely to have the very banking and financial services they need most.[26] With respect to minority communities in particular, despite meaningful improvements in recent years, the rates for Black and Hispanic households who do not have a checking or savings account at a bank remain substantially higher than the overall "unbanked" rate. Similarly, Black and Hispanic households are less likely to have mainstream credit (*i.e.*, credit products that are likely reported to credit bureaus) across all income levels.[27] And savings rates remain lower among these households,[28] which results in greater difficulty dealing with unexpected expenses.[29]

These disparities pose challenges to regulators and other policymakers about how best to address them. While we recognize there is no single solution, I would like to discuss the FDIC's initiatives to promote and preserve MDIs.

*Preserving and Promoting MDIs*

Shaped by my personal experiences and guided by a commitment to increasing financial inclusion in traditionally underserved communities, one of my priorities as FDIC Chairman has been expanding our engagement and collaboration in support of MDIs. An MDI is often the financial lifeblood of the community it serves, enabling individuals and minority-owned small businesses to securely build savings and obtain credit.[30] Although the number of MDIs is comparatively small relative to the total number of FDIC-insured institutions, these banks have a substantial impact on their communities, including through mortgage lending and small business lending.

We have embraced our statutory responsibility to promote and preserve the health of MDIs by seeking new and innovative ways to engage with these institutions and better understand their needs. The FDIC frequently engages with MDIs in Washington and throughout our six regions with technical assistance, banker roundtables, and networking events to connect MDIs and non-MDIs for potential business partnerships.

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[26] *See* How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey, available at https://www.fdic.gov/analysis/household-survey/2019report.pdf. In 2019, 5.4 percent of U.S. households were "unbanked," meaning that no one in the household had a checking or savings account. By comparison, 13.8 percent of Black households were unbanked and 12.2 percent of Hispanic households were unbanked.
[27] *See id.* at 10. While 19.7 percent of U.S. households in 2017 had no mainstream credit in the past 12 months, 36 percent of Black households and 31.5 percent of Hispanic households had no mainstream credit.
[28] *See id.* at 44.
[29] *See* Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2019, Featuring Supplemental Data from April 2020* (May 2020), available at https://www.federalreserve.gov/publications/files/2019-report-economic-well-being-us-households-202005.pdf.
[30] *See, e.g.*, James Barth, Aron Betru, Matthew Brigida, and Christopher Lee, *Minority-Owned Depository Institutions: A Market Overview*, Milken Institute (July 2018), available at https://milkeninstitute.org/sites/default/files/reports-pdf/MDIs-A-Market-Overview.2018.FINAL.pdf.

Last year, the FDIC published a comprehensive research study analyzing the demographics, structural change, geography, financial performance, and social impact of MDIs over a 17-year period ending December 31, 2018.[31] Although the study found improvements in MDIs' financial performance, it also observed that many MDIs face greater economic challenges than non-MDI community banks.

To address some of these challenges, the FDIC has:

- Tripled MDI representation on our Community Bank Advisory Committee (CBAC);[32]
- Established a new MDI subcommittee on the CBAC to highlight the work of MDIs in their communities and to provide a platform for MDIs to exchange best practices;[33]
- Enabled MDIs to review potential purchases of a failing MDI before non-MDI institutions are given this opportunity;
- Clarified that non-MDIs can receive Community Reinvestment Act credit for their collaboration with MDIs;
- Facilitated commitments to support MDIs, including most notably a $100 million commitment by Microsoft;[34] and
- Published a resource guide to promote private and philanthropic investment partnerships with MDIs and Community Development Financial Institutions (CDFIs).[35]

Notwithstanding these important steps, we recognize that we can do more, and "more" in this case will require us to think outside the box.

One of the options we are exploring to support MDIs and CDFIs is a framework that would match these banks with investors interested in the particular challenges and opportunities facing those institutions and their communities. Although we are still developing the details, we are in the process of creating a vehicle through which investors' funds would be channeled to make investments in or with MDIs and CDFIs, including direct equity, structured transactions, funding commitments to loan participations, or potential loss-share arrangements.

This initiative seeks to accomplish several objectives, including maximizing the benefits to MDIs and the communities they serve by providing capital preservation and growth, as well as providing a minimal return to investors.[36] We expect to release more information in the near future.

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[31] *See* FDIC, *Minority Depository Institutions: Structure, Performance, and Social Impact*, available at https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.
[32] *See* FDIC Advisory Committee on Community Banking, available at https://www.fdic.gov/communitybanking.
[33] *See* MDI Subcommittee to FDIC's Advisory Committee on Community Banking, available at https://www.fdic.gov/regulations/resources/minority/subcommittee/index.html
[34] *See* Microsoft, "Addressing racial injustice" (June 23, 2020), available at https://blogs.microsoft.com/blog/2020/06/23/addressing-racial-injustice/.
[35] *See* FDIC, *Investing in the Future of Mission-Driven Banks*, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/guide.pdf.
[36] *See* FDIC, Investing in Banks That Support Communities in Need, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/infographic.pdf; *see also* FDIC, Minority Depository Institutions Program, Investing in the Future of Mission-Driven Banks, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/index.html.

*Diversity and Inclusion at the FDIC*

The FDIC is deeply committed to fostering a diverse workforce and inclusive work environment. Although we are not yet satisfied with our progress or the pace of change, we have taken meaningful steps in furtherance of this goal.

The racial, ethnic, and gender diversity of the FDIC workforce continues to steadily increase. At the end of 2019, minorities represented over 30 percent of the permanent workforce and women accounted for approximately 45 percent.[37] The FDIC has also increased diversity across our leadership: minorities hold 22 percent of the management-level positions at the FDIC, and women hold 39 percent (up from almost 16 percent and 30 percent, respectively, ten years ago).[38] Likewise, my senior leadership team comprises a diverse set of individuals (38 percent women and 29 percent minorities).[39] Notwithstanding this progress to close longstanding gaps, we know more needs to be done, and we are fully committed to doing it.[40]

In addition to increasing the diversity of our workforce, we also promote the participation of minority- and women-owned businesses (MWOBs) in contracting actions.[41] In 2019, the FDIC awarded 152 contracts, or 29 percent of all contracts, to MWOBs with a total value of approximately $174 million, or 31 percent of all new awards. For any contract over $100,000, review by the Office of Minority and Women Inclusion (OMWI) is required to identify competitive MWOBs to include in contract solicitations. The FDIC has taken a number of actions in 2020 to improve the ability of MWOBs to compete for contracts.

The Legal Division's contracting program endeavors to maximize the participation of both minority- and women-owned law firms (MWOLFs) and minority and women partners and associates employed at majority-owned firms (Diverse Attorneys) in legal contracting. In 2019, the FDIC paid nearly $11 million to MWOLFs and Diverse Attorneys combined, out of a total of approximately $32 million (34 percent) paid to outside counsel. The FDIC made 62 referrals to outside counsel in 2019, of which 20 (32 percent) were to MWOLFs.

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[37] *See* FDIC, Office of Minority and Women Inclusion, *Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress* (2019), available at https://www.fdic.gov/about/diversity/pdf/rtc32620.pdf.

[38] As of September 30, 2020.

[39] As of September 30, 2020.

[40] For a more detailed description of our work in this area, see Nikita Pearson, Acting Director, Office of Women and Minority Inclusion, Federal Deposit Insurance Corporation, "Holding Financial Regulators Accountable for Diversity and Inclusion: Perspectives from The Offices of Minority and Women Inclusion," testimony before H. Comm. on Fin. Servs. (Sept. 8, 2020), available at https://www.fdic.gov/news/speeches/spsep0820.html.

[41] Section 342(c)(2) of the Dodd-Frank Act provides that "[t]he procedures established by each agency for review and evaluation of contract proposals and for hiring service providers shall include, to the extent consistent with applicable law, a component that gives consideration to the diversity of the applicant. Such procedure shall include a written statement, in a form and with such content as the Director shall prescribe, that a contractor shall ensure, to the maximum extent possible, the fair inclusion of women and minorities in the workforce of the contractor and, as applicable, subcontractors."

## IV. Fostering Technology Solutions and Encouraging Innovation

As we consider additional ways to create a more inclusive banking system, we must recognize the tremendous benefits that financial innovation can deliver to consumers, including in the areas of payments and credit. New technologies have the potential to bring more people into the banking system, provide access to new products and services, and lower the cost of credit.

For example, last month we released our latest biennial survey on household use of banking and financial services, which shows that individuals have been increasingly moving to digital banking.[42] Specifically, mobile banking and online banking are now the primary methods used to access bank accounts for more than 56 percent of banked households, while use of bank tellers is the primary method for only 21 percent of banked households. Because the survey was conducted in June 2019, it does not reflect changes in consumer behavior associated with the COVID-19 pandemic.

As these trends continue, regulators should aim to foster the development of new technologies that improve the way banks operate by working to remove unnecessary barriers that create operational and regulatory uncertainty for institutions that want to innovate, but are reluctant to do so.[43]

For some community banks, including MDIs, the path to innovation can be challenging. The cost to innovate is often prohibitively high. They may lack the expertise, information technology infrastructure, or research and development budgets to independently develop and deploy their own technology.

To help overcome these challenges, we established an office of innovation – FDiTech – in 2019, and began working on several initiatives to promote innovation and support financial inclusion.

*Alternative Data*

To help facilitate greater access to credit using new technologies, the FDIC and our fellow regulators issued a statement encouraging the responsible use of alternative data in credit underwriting.[44] Alternative data is information not typically found in the consumer's credit files of the nationwide consumer reporting agencies or customarily provided as part of applications for credit. Using alternative data can improve the speed and accuracy of credit decisions and help firms evaluate the creditworthiness of consumers who might not otherwise have access to credit in the mainstream credit system.

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[42] *See* How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey, available at https://www.fdic.gov/analysis/household-survey/2019report.pdf.
[43] *See* FDIC Chairman Jelena McWilliams, "The Future of Banking," speech before the Federal Reserve Bank of St. Louis (Oct. 1, 2019), available at https://www.fdic.gov/news/news/speeches/spoct0119.html.
[44] *See* Federal Regulators issue joint statement on the use of alternative data in credit underwriting (Dec. 3, 2019), available at https://www.fdic.gov/news/news/press/2019/pr19117.html.

*Small-Dollar Lending*

Similarly, we worked with our fellow regulators earlier this year to issue principles encouraging financial institutions to offer responsible small-dollar loans to customers for both consumer and small business purposes.[45] Even before the COVID-19 pandemic and economic shutdowns throughout the country caused many consumers to lose their jobs, we recognized the important role that such loans can play in helping customers meet their ongoing needs for credit due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national emergencies, or disasters.

Small-dollar credit products and the use of alternative data in underwriting can create a powerful combination for LMI consumers. Our new guidance documents can help encourage FDIC-supervised institutions to offer products to existing and potential customers, consistent with safe and sound banking principles and consumer protection laws.

*Partnerships*

We are also working on numerous initiatives to facilitate partnerships between fintechs and banks. These partnerships are particularly important to financial inclusion, allowing banks to partner with fintechs that have already developed innovative products and underwriting methods that banks can quickly and safely adopt to support their customers.

To help encourage these partnerships, the FDIC issued earlier this year a guide for fintechs and other third parties looking to work with banks.[46] Using the guide, fintechs that may be new to bank partnerships can gain a better understanding of applicable risk management principles and the due diligence processes banks generally follow to meet them.

More recently, we asked stakeholders to comment on a groundbreaking approach to facilitate technology partnerships. Our request for information proposed a public/private standard-setting partnership and voluntary certification program that would help reduce the cost and uncertainty associated with the introduction of new technology at an institution.[47]

Risk management is an important component of third-party partnerships with banks. But the on-boarding and due diligence process can be costly and time consuming for both banks and their potential technology vendors. These challenges are often amplified at community banks with tight budgets and limited technology expertise. The costs are also high for technology firms. Each bank often has a somewhat different approach to due diligence, and the paperwork and review requirements for vendors are multiplied at each new institution.

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[45] *See* Federal Agencies Share Principles for Offering Responsible Small-Dollar Loans (May 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20061.html.
[46] *See* FDIC, *Conducting Business with Banks: A Guide For Fintechs And Third Parties* (February 2020), available at https://www.fdic.gov/fditech/guide.pdf.
[47] *See* Request for Information on Standard Setting and Voluntary Certification for Models and Third-Party Providers of Technology and Other Services, 85 Fed. Reg. 44890 (July 24, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-24/pdf/2020-16058.pdf.

The voluntary certification program we have proposed would create a standard setting organization to establish standards for due diligence of vendors and for the technologies they develop. The FDIC would participate with industry and other stakeholders in the development of these standards. Third-party providers, including fintechs, could then voluntarily submit their organization and technologies to an independent certifying organization to verify conformance to the applicable standards. In turn, banks could rely on this certification to on-board the vendor and integrate the technology into bank operations. Banks would continue to be responsible for exercising appropriate oversight over these vendors, and the products and services offered would still need to comply with all applicable laws, including consumer protection and anti-discrimination.

Standardizing the due diligence process and removing regulatory and operational uncertainty surrounding technologies could fundamentally change the way banks partner with technology firms. We received numerous comments on the proposal, and are reviewing them as we consider next steps.

*Financial Reporting*

In addition, we recently announced the start of a rapid prototyping competition to help develop a new and innovative approach to financial reporting.[48] Specifically, we invited over 30 technology firms to develop tools for providing more timely and granular data to the FDIC on the health of the banking industry while also making such reporting less burdensome for banks. Last month, we selected 15 of these firms to compete in the next phrase of the competition, in which they will demonstrate their initial prototypes within 70 days and, if selected to continue, a fully functional prototype in 180 days.[49]

Targeted data sets from community banks, more frequently available and more granular than current reporting, could reduce the need for cumbersome quarterly reporting. Such a modernized and automated data system would also improve the ability of supervisors to identify bank-specific and system-wide risks sooner and more efficiently, while simultaneously reducing the compliance burden on individual institutions who voluntarily adopt the technology.

These are only a few of the actions we are taking to facilitate the introduction of innovative technology into the banking industry. We expect them to make banks more efficient and to help introduce new products and services to the market that are safe, affordable, and accessible.

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[48] *See* FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html. Several firms were added as competitors between the initial announcement and the time the final concept papers were due.
[49] *See* FDIC Selects 14 Companies in Tech Sprint to Modernize Bank Financial Reporting (Oct. 15, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20109.html. One additional firm completed contract negotiations a few weeks after this release.

## V. Finalizing Outstanding Rulemakings

Although the FDIC does not currently have many open rulemakings, we continue to focus our efforts on modernizing and improving the efficiency and resiliency of the financial system. With respect to rulemakings for which the FDIC has sole jurisdiction, we have prioritized those that are necessary or appropriate at this time and that will not disrupt or add unnecessary uncertainty to the market during time of great volatility. With these principles in mind, the FDIC recently finalized two rules and intends to finalize two others in the near future.

*Federal Interest Rate Authority*

Earlier this year, the FDIC issued a final rule to clarify the law governing the interest rates state banks may charge.[50] The rule codifies longstanding FDIC guidance to address marketplace uncertainty regarding the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a nonbank. In 2015, the United States Court of Appeals for the Second Circuit issued a decision that called into question such enforceability by holding that 12 U.S.C. § 85 – which authorizes national banks to charge interest at the rate permitted by the law of the state in which the bank is located, regardless of other states' interest rate restrictions – does not apply following assignment of a loan to a nonbank.[51] Although this decision concerned a loan made by a national bank, the Federal Deposit Insurance (FDI) Act provision governing state banks' authority with respect to interest rates is patterned after and interpreted in the same manner.[52]

The final rule addresses this uncertainty and accomplishes three important safeguards for the stability of our financial system by promoting safety and soundness, solidifying the functioning of a robust secondary market, and enabling the FDIC to fulfill its statutory mandate to minimize risk to the DIF.

*Section 19*

Section 19 of the FDI Act prohibits, without the prior written consent of the FDIC, any person who has been convicted of certain types of crimes, or who has entered into a pretrial diversion or similar program for such crimes, from working at a bank.

Earlier this year, the FDIC issued a final rule that codifies our Statement of Policy (SOP) related to Section 19 and makes several significant changes to the SOP.[53] The changes narrow the scope of crimes subject to Section 19, enabling more individuals to work for banks without going through the Section 19 application process, without increasing risk to the DIF. Among other things, the final rule (1) excludes *all* offenses that have been expunged or sealed – rather than only certain types of expungements – from the scope of Section 19, (2) allows a person with

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[50] *See* Federal Interest Rate Authority, 85 Fed. Reg. 44146 (July 22, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-22/pdf/2020-14114.pdf.
[51] *See* Madden v. Midland Funding, LLC, 786 F.3d 246 (2d Cir. 2015), cert. denied, 136 S. Ct. 2505 (2016).
[52] 12 U.S.C. §1831d.
[53] *See* Incorporation of Existing Statement of Policy Regarding Requests for Participation in the Affairs of an Insured Depository Institution by Convicted Individuals, 85 Fed. Reg. 51312 (Aug. 20, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-08-20/pdf/2020-16464.pdf.

two, rather than one, minor *de minimis* crimes on a criminal record to qualify for the *de minimis* exception, and (3) eliminates the five-year waiting period following a first *de minimis* conviction and establishes a three-year waiting period following a second *de minimis* conviction (or 18 months for individuals whose misconduct occurred when they were 21 or younger).

*Brokered Deposits and Interest Rate Caps*

Last year, we began a comprehensive review of our longstanding regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized. Since the statutory brokered deposit and rate restrictions applicable to less than well capitalized banks were put in place in 1989 (and amended in 1991), the financial services industry has seen significant changes in technology, business models, and products. In February, we issued an ANPR[54] to seek public comment on all aspects of these regulations.

After considering feedback from the ANPR, we issued a proposed rule that would amend the methodology for calculating the national rate and national rate cap for specific deposit products.[55] Subsequently, we issued a proposed rule that would modernize our brokered deposit regulations.[56] These rulemakings are designed to establish a framework that encourages innovation and provides greater clarity and consistency. We have considered substantial public feedback on the proposals and intend to issue a final rule before the end of the year.

*Industrial Loan Companies (ILCs)*

ILCs and industrial banks (collectively, "ILCs") are state-chartered, FDIC-supervised financial institutions that can be owned by financial or commercial firms.[57] Congress authorized federal deposit insurance for ILCs in 1982,[58] and exempted ILCs from the definition of "bank" under the Bank Holding Company Act in 1987.[59] These institutions are subject to the same statutory standards as other IDIs for which the FDIC is the primary supervisor. An approved ILC is also subject to the same FDIC safety and soundness, Community Reinvestment Act, and consumer protection requirements as other banks. Earlier this year, we issued a proposed rule that would codify legally enforceable commitments the FDIC generally requires ILCs and their parent companies to enter into as a condition of approval.[60] We intend to finalize this rule in the near future.

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[54] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.
[55] *See* Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized, 84 Fed. Reg. 46470 (Sep. 4, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-09-04/pdf/2019-18360.pdf.
[56] *See* Unsafe and Unsound Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf.
[57] *See* FDIC Supervisory Insights, *Supervision of Industrial Loan Companies* (Summer 2004), available at https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/sisum04.pdf.
[58] *See* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (1982).
[59] *See* Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552 (Aug. 10, 1987).
[60] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 85 Fed. Reg. 17771 (Mar. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-06153.pdf.

In addition to these FDIC-only rulemakings, we have engaged with our fellow regulators on a number of interagency rulemakings.

*Volcker Rule*

The Volcker Rule has been one of the most challenging post-crisis reforms for regulators and institutions to implement.[61] The rule generally prohibits large banking entities from engaging in proprietary trading and limits their ability to sponsor or own hedge funds or private equity funds. While the intent of the statute is straightforward, the proprietary trading restrictions were inefficient and the "covered fund" provisions were overly restrictive.

After the five agencies responsible for the Volcker Rule finalized changes to improve the efficiency of the proprietary trading restrictions last year,[62] earlier this year, the agencies finalized changes to revise the restrictions on fund investments in a way that addresses over-breadth while remaining faithful to the statute.[63] We undertook this process out of recognition that, as originally written and implemented, the regulations placed restrictions on several investment funds that the Volcker Rule was never intended to cover. To facilitate capital formation, the rule enables banking entities to provide credit through fund investments that could increase the availability of capital for businesses across the country.

*Initial Margin*

The mandatory exchange of initial and variation margin for non-cleared swaps is a critical regulatory requirement that reduces the ability of firms to take on excessive risks through swaps without sufficient financial resources. After issuing regulations to implement these requirements five years ago,[64] the FDIC and our fellow regulators made several targeted changes to the framework, including a modification to the requirement that an IDI collect initial margin from affiliates.[65]

Recognizing that banking organizations use inter-affiliate swaps for internal risk management purposes, the rule does not require an IDI to collect initial margin from affiliates until the aggregate amount of such initial margin exceeds 15 percent of the IDI's tier 1 capital. This rule protects the DIF by preventing banking organizations from transferring significant levels of risk to IDIs while also facilitating prudent risk management through inter-affiliate swaps. Importantly, under the rule, all non-cleared swaps – including those with affiliates –

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[61] There have been over 30 interagency issuances to implement the Volcker Rule, including proposals, final rules, and 21 FAQs. *See, e.g.*, FDIC, The Volcker Rule: Frequently Asked Questions, available at https://www.fdic.gov/regulations/reform/volcker/faq/Volcker_Website_FAQs.pdf.

[62] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 61974 (Nov. 14, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-14/pdf/2019-22695.pdf.

[63] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 46422 (July 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-31/pdf/2020-15525.pdf.

[64] *See* Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015), available at https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf.

[65] *See* Margin and Capital Requirements for Covered Swap Entities, 85 Fed. Reg. 39754 (July 1, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-01/pdf/2020-14097.pdf.

remain subject to variation margin, which is calculated and transferred on a daily basis based on the value of the contract.

*Net Stable Funding Ratio (NSFR)*

Strong liquidity requirements for the largest, most systemically important banks are a key pillar of the post-crisis regulatory framework. In 2014, the FDIC, FRB, and OCC finalized the Liquidity Coverage Ratio (LCR), the first quantitative liquidity standard for U.S. banks.[66] The LCR requires the largest banks to maintain high-quality liquid assets (HQLA) of at least 100 percent of total net cash outflows over a 30-day period.

Last month, we issued a final rule to implement the Net Stable Funding Ratio (NSFR), which complements the LCR by establishing a long-term quantitative liquidity metric. The NSFR will require covered banks to maintain stable funding to support their assets, commitments, and derivatives exposures over a one-year time horizon. Consistent with the tailoring rule,[67] the NSFR will apply based on a bank's size, risk profile, and systemic footprint.

## VI. Conclusion

As the FDIC makes progress on these important objectives, we will continue to fulfill our critical mission of maintaining stability and public confidence in the nation's financial system.

Thank you again for the opportunity to testify today, and I look forward to answering your questions.

[66] *See* Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61440 (Oct. 10, 2014), available at https://www.govinfo.gov/content/pkg/FR-2014-10-10/pdf/2014-22520.pdf.
[67] *See* Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.

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Statement by

Randal K. Quarles

Vice Chair for Supervision

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

November 12, 2020

Chairwoman Waters, Ranking Member McHenry, members of the committee, thank you for the opportunity to testify today on the Federal Reserve's supervisory activities in the context of the ongoing pandemic.

My last appearance, in May, followed a period of historic financial stress.[1] The emergence of COVID-19, and the measures taken in response (together, the "COVID event"), added a deep strain of uncertainty to financial markets. It prompted a sharp and global flight from riskier, more volatile asset classes, and a retreat to the safety of cash. That retreat demanded immediate, extraordinary, and concerted public intervention, to ensure stability, restore calm, and see the nation through an unfolding crisis.

For the Federal Reserve, that intervention spanned a wide range of financial intermediaries and markets, including the banking sector.[2] Strengthened by a decade of improvements in capital, liquidity, and risk management, including the refinement and recalibration of the last three years, banking organizations became an important shelter from financial distress. Our goal was to ensure this shelter stood fast—that banks could respond to the emergency, and address consumer, business, and community needs, without jeopardizing their own safety and soundness.

The report accompanying my testimony lists these actions in detail, and we have extended several of them as the COVID event has continued.[3] They range from temporary

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[1] Randal K. Quarles, "Supervision and Regulation Report" (testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., May 12, 2020), https://www.federalreserve.gov/newsevents/testimony/quarles20200512a.htm.

[2] I have recently spoken on the broader strains in the financial system and the significant efforts made to address them. See Randal K. Quarles, "What Happened? What Have We Learned From It? Lessons from COVID-19 Stress on the Financial System" (speech at the Institute of International Finance, Washington, D.C. (via webcast), October 15, 2020), https://www federalreserve.gov/newsevents/speech/quarles20201015a.htm. My remarks today principally describe interventions focused on the banking sector.

[3] For a full list of such actions, see Board of Governors of the Federal Reserve System, "Supervision and Regulation Report," November 2020, https://www federalreserve.gov/publications/files/202011-supervision-and-regulation-report.pdf.

adjustments to capital and reserve measures, to temporary changes in compliance requirements, to temporary shifts toward off-site examination activities, to temporary delays in the implementation of new standards. They include specific guidance on the use of capital and liquidity buffers. They clarify, beyond doubt, that safety and soundness are no impediment to working constructively with customers, including borrowers, in a time of strain.

Together with monetary, financial stability, and fiscal actions, these measures helped calm the waters. The initial wave of market stress has passed, and the recovery has begun much sooner than expected. This speaks to the country's tenacity, ingenuity, and spirit in responding to even the greatest of shocks.

The challenge we face now is distinct, formidable, and complex. The surprise of the COVID event is gone, replaced by a clearer view of its economic consequences. The burdens facing households and businesses are better understood, but they are no less significant, and they are not evenly borne. I am confident that we will work through them together, support those hardest hit, and ensure that our economic wounds do not become scars.

The Federal Reserve remains committed to using our full range of tools to support the economy for as long as needed, and a strong, resilient banking system is an essential element of such support. A durable recovery demands banks that lend actively, confront gains and losses honestly, withstand unexpected shocks, and help customers rebuild and adapt to the new landscape. Our task, as supervisors, is to ensure the country's banks continue to meet that exacting standard.

The Federal Reserve's earliest COVID-related guidance, encouraging banks to work constructively with borrowers, was an important step toward this goal. Since then, working with our colleagues in other financial regulatory agencies, we have taken several others:

- We published a set of key principles to guide COVID-related credit accommodations, in ways that meet customer needs while preserving safety and soundness.[4]
- We offered new guidance on bank examinations during the COVID event, ensuring they consider the unique, evolving, and potentially long-term issues that institutions face.[5]
- We clarified our approach to COVID-event-related activity under the Community Reinvestment Act (CRA), and to granting consideration for investments that protect public health and safety.[6]
- And building on targeted, temporary changes to capital requirements this spring, such as temporarily removing reserves and treasuries from the denominator of the supplementary leverage ratio, we supported banks' ability to address customer needs by easing their path to participate in emergency programs—to issue loans in the Paycheck Protection Program, underwrite loans in the Main Street Lending Program, and act as counterparties in several other facilities.[7]

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[4] Board of Governors of the Federal Reserve System, SR 20-18 / CA 20-13: "Joint Statement on Additional Loan Accommodations Related to COVID-19," https://www.federalreserve.gov/supervisionreg/srletters/SR2018 htm.
[5] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, National Credit Union Administration, and State Financial Regulators, "Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," June 2020, https://www federalreserve.gov/newsevents/pressreleases/files/bcreg20200623a1.pdf.
[6] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Community Reinvestment Act (CRA) Consideration for Activities in Response to the Coronavirus Frequently Asked Questions (FAQs)," May 27, 2020, https://www.federalreserve.gov/supervisionreg/caletters/CA%2020-10%20Attachment%20CRA%20Consideration%20for%20Activities%20in%20Response%20to%20COVID-19%20FAQs%20-%20Final.pdf.
[7] Deliberate outreach to community development financial institutions (CDFIs) and minority depository institutions (MDIs) has been a key aspect of these efforts. See Lael Brainard, "Modernizing and Strengthening CRA Regulations: A Conversation with Minority Depository Institutions" (speech at the National Bankers Association (via webcast), October 15, 2020), https://www.federalreserve.gov/newsevents/speech/brainard20201015a.htm (noting preliminary data showing CDFIs, MDIs, and other community banks as source of 73 percent of all Paycheck Protection Program loans to minority-owned businesses); see also Board of Governors of the Federal Reserve System, "Federal Reserve Board updates frequently asked questions to clarify the Board and Department of Treasury's expectations regarding lender underwriting for the Main Street Lending Program," news release, September 18, 2020, https://www federalreserve.gov/newsevents/pressreleases/monetary20200918a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board announces extension of rule change to bolster effectiveness of the Small Business Administration's Paycheck Protection Program," news release, July 15, 2020,

We also used the flexibility in our stress-testing apparatus to better understand the effects of the COVID-event shock.[8] This framework, like the data associated with it, has long been a key part of day-to-day banking supervision. However, it was born in and built for a crisis, to cut through panic, clarify the health of the largest financial firms, and provide the certainty needed to restore confidence.[9] In that spirit, and under the constraints of a fast-moving market event, we conducted and published a "sensitivity analysis," examining how institutions would fare in a prolonged downturn. The banking system remained well capitalized in the downside scenarios we examined. But in light of continuing uncertainty, we took several steps to preserve bank capital—and with it, banks' role as a source of economic strength.[10] We are conducting a second round of stress tests toward that same goal, with results announced before the end of this year.

As our report shows, that strength is still intact. Liquidity and capital remain high and, indeed, have increased at our largest banks over the course of the COVID event. Firms have sharply increased their reserves, setting aside resources today against losses they may incur

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https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200715a.htm; and Board of Governors of the Federal Reserve System, "Federal Reserve Board announces expansion of counterparties in the Term Asset-Backed Securities Loan Facility, Secondary Market Corporate Credit Facility, and Commercial Paper Funding Facility," news release, July 23, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20200723a.htm; see also, e.g., Board of Governors of the Federal Reserve System, "Federal Reserve Board announces temporary change to its supplementary leverage ratio rule to ease strains in the Treasury market resulting from the coronavirus and increase banking organizations' ability to provide credit to households and businesses," news release, April 1, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm; and Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies announce changes to the community bank leverage ratio," news release, April 6, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm.

[8] Randal K. Quarles, "The Adaptability of Stress Testing" (speech at Women in Housing and Finance, Washington, D.C., June 19, 2020), https://www.federalreserve.gov/newsevents/speech/quarles20200619a htm.

[9] Randal K. Quarles, "Stress Testing: A Decade of Continuity and Change" (speech at "Stress Testing: A Discussion and Review," a research conference sponsored by the Federal Reserve Bank of Boston, Boston, MA, July 9, 2019), https://www.federalreserve.gov/newsevents/speech/quarles20190709a htm.

[10] Board of Governors of the Federal Reserve System, "Federal Reserve Board releases results of stress tests for 2020 and additional sensitivity analyses conducted in light of the coronavirus event," news release, June 25, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm; and Board of Governors of the Federal Reserve System, "Federal Reserve Board announces it will extend for an additional quarter several measures to ensure that large banks maintain a high level of capital resilience," news release, September 30, 2020, available at https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930b htm.

tomorrow. Banks are well positioned to serve as a bulwark against broader financial and economic stress.

It is worth recognizing how things might have been different. This foundation would not exist, after a once-in-a-century shock, if not for a decade of work by officials and the banks themselves to make banks stronger and more stable, and to make banking supervision fairer, more efficient, and more transparent. Those values are not contingent, fit only for an economic boom. They represent an ethic and a commitment—to addressing the most pressing supervisory and regulatory issues in the most effective ways—that are even more critical during a crisis.

That ethic has steered the Federal Reserve through the last seven months, and it will continue to guide us through the recovery. It applies to our efforts to complete the implementation of Basel III reforms like the net stable funding ratio, tailoring them to the activities and risks of different institutions. It applies to our recent work to streamline the Volcker rule and swap margin rule.[11] It applies to our assessment of the lessons of the COVID-event shock, understanding which parts of our regulatory framework functioned well and which need improvement.[12] It applies to our international engagement, to ensure that global financial rules do not splinter and fragment as we gradually return to normal.[13]

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[11] Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities and Exchange Commission, "Financial regulators modify Volcker rule," news release, June 25, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm; and Board of Governors of the Federal Reserve System, Farm Credit Administration, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, and Office of the Comptroller of the Currency, "Agencies finalize amendments to swap margin rule," news release, June 25, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625b htm.

[12] See Quarles, note 2.

[13] Randal K. Quarles, "Global in Life and Orderly in Death: Post-Crisis Reforms and the Too-Big-to-Fail Question" (speech at the Exchequer Club, Washington, D.C. (via webcast), July 7, 2020), https://www.federalreserve.gov/newsevents/speech/quarles20200707a htm.

COVID-19 changed many aspects of the Federal Reserve's work. It also affirmed the values and priorities that remain the same—those that will continue to guide us in our support for the financial system, the economy, and the country, long after the COVID event has passed.

Thank you for your time. I look forward to answering your questions.

# Supervision and Regulation Report

November 2020

Board of Governors of the Federal Reserve System

# Supervision and Regulation Report

November 2020

Board of Governors of the Federal Reserve System

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# Preface

To enhance public transparency and heighten accountability, the Federal Reserve Board (Board) publishes periodic information about banking conditions and the Federal Reserve's supervisory and regulatory activities, typically in conjunction with testimony before Congress by the Vice Chair for Supervision.

The inaugural report was published in November 2018. This report focuses on the Federal Reserve's supervisory and regulatory response to the economic and financial stresses resulting from containment measures adopted in response to current public health concerns, referred to as the "COVID event."[1]

The report consists of three main sections, in addition to a summary of key developments and trends:

- **Banking System Conditions** provides an overview of current conditions in the banking sector based on data collected by the Federal Reserve and other federal financial regulatory agencies, as well as market indicators of industry conditions.
- **Regulatory Developments** provides an overview of the current areas of focus of the Federal Reserve's regulatory policy work, including proposed rules.
- **Supervisory Developments** provides information on supervisory programs and approaches in light of recent events. The report distinguishes between large financial institutions and community and regional banking organizations, as supervisory approaches and priorities for these institutions frequently differ.

[1] The term "COVID event" refers to the complex set of responses in both the private and public sectors to the outbreak of COVID-19.

# Contents

# Summary

One of the principal functions of the Federal Reserve is to regulate and promote the safety, soundness, and efficiency of supervised financial institutions. The COVID event continues to present extraordinary challenges to both financial institutions and regulators, and has imposed widespread and significant damage on households, businesses, and the broader economy.

This report details how Federal Reserve banking regulation and supervision is responding to unprecedented challenges. Unlike 2008, banking organizations have been a source of strength, rather than strain, to the economy, entering the COVID event with substantial capital and liquidity and improved risk management and operational resiliency. In response to the COVID event, the Federal Reserve has made several adjustments to its regulation and supervision, many temporary, to reduce burden on banking organizations and help them meet the needs of their customers and communities.

The future course and timing of the economic recovery remain uncertain, and its pace and intensity are likely to vary across different areas of the country. The Federal Reserve will continue to ensure that its regulations, supervisory policies, and examination activities are effective and efficient. We remain committed to using our full range of tools to support the economy for as long as is needed.

# Banking System Conditions

## Evolution of the COVID event

As noted in the previous *Supervision and Regulation Report*, the COVID event caused acute stress in many parts of the financial system beginning in March 2020.[2] It induced a sharp decline in economic activity and an accompanying surge in unemployment. Since then, market conditions and investor risk sentiment have improved substantially, though issues continue to exist in various sectors. Some asset prices have largely recovered, in part because of strong and rapid policy responses. However, while recent economic data offer positive signs, output and employment remain far below their levels prior to the COVID event, and the path forward remains uncertain. Recovery hinges in large part on the evolution of public concern about the virus as well as on policy actions taken at all levels of government.

The COVID event differs from previous crises in at least one important way. Because the economic shock emerged outside of a banking system that was significantly more resilient as a result of reforms and measures taken by the banking industry following the 2008 crisis, the role of banking organizations in this crisis has been different—serving as shock absorbers for the real economy, rather than as amplifiers of stress. Programs undertaken by the Federal Reserve have helped to preserve the flow of credit, while policy measures have helped build a bridge from the solid economic foundation on which we entered the crisis to a position of potential economic strength on the other side.

## A More Resilient Banking System Has Helped the Economy Weather the Initial Shock

As the crisis broke, the benefits of a more resilient banking system were evident. Despite a great deal of turmoil in financial markets, the solvency of the banking system has not been in question. Banks have increased lending, absorbed a surge of deposits, and worked constructively with borrowers. They have also provided access to substantial lines of credit for corporate borrowers and played a significant role in supporting small businesses via the Paycheck Protection Program (PPP).

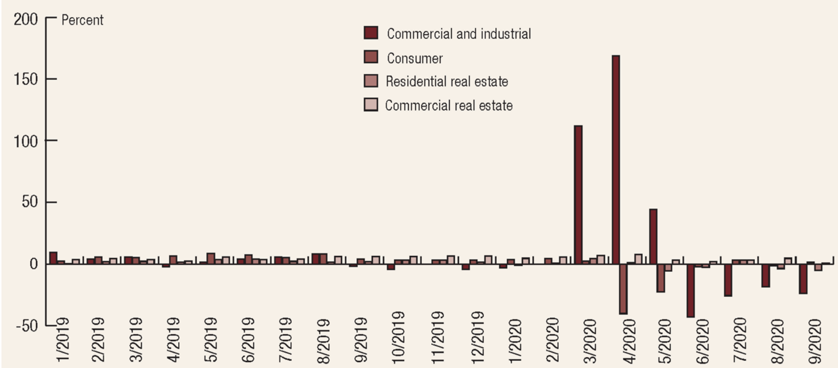
Banks also took a number of actions to maintain financial and operational resiliency. As a result, capital levels remain robust—indeed, they have actually increased during the COVID event—aided by timely policy response and capital preservation measures. Despite operational challenges, both banks and examiners have generally transitioned to a largely remote work environment without significant disruption to the provision of financial services. Bank branches have begun to reopen in line with local conditions and relevant guidelines.

### *Loan growth has moderated in recent months.*

Since the beginning of the year, bank loans have grown by slightly more than 4 percent, driven mainly by the PPP. After increasing through May, total loan growth turned negative in June. Growth rates for commercial and industrial (C&I) and consumer loans in particular saw significant declines (figure 1), driven principally by weak loan demand. Despite approxi-

[2] See Board of Governors of the Federal Reserve System, *Supervision and Regulation Report, May 2020,* (Washington: Board of Governors, May), https://www.federalreserve.gov/publications/2020-may-supervision-and-regulation-report.htm.

**Figure 1. Loan growth by sector (seasonally adjusted, annual rate)**




Note: Growth rate is annualized month-over-month change, based on estimated weekly aggregate balance sheets for all commercial banks in the United States. Key identifies bars in order from left to right.

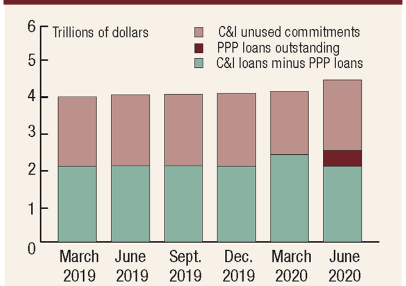
Source: H.8, "Assets and Liabilities of Commercial Banks in the United States."

mately $500 billion in PPP loans originated by banks between April and August, C&I lending slowed as commitment draws began to be repaid (figure 2). Consumer loan growth declined as consumers reduced spending. Along with lower loan demand, tighter lending standards and greater uncertainty also contributed to declines.

### *Capital positions remain strong.*

The aggregate common equity tier 1 (CET1) capital ratio recovered in the second quarter to around 12 percent, up from the first quarter and similar to the level at the end of 2019 (figure 3). Capital ratios rose slightly in the third quarter, based on preliminary reports from

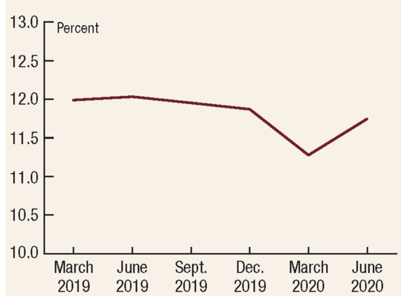
**Figure 2. Commercial and industrial (C&I) loans and unused commitments**




Note: Assumes all PPP loans are C&I loans. Capping the institution-level PPP loan amount at the C&I loan amount would reduce total PPP loans by about $150 million. Key identifies bars in order from top to bottom.

Source: Call Report and FR Y-9C.

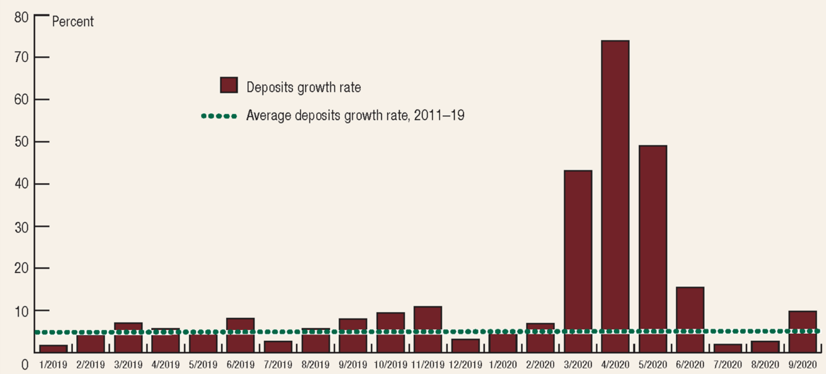
**Figure 3. Aggregate common equity tier 1 (CET1) capital ratio**




Note: CET1 capital ratio is the ratio of common equity tier 1 capital to risk-weighted assets. See the data appendix for further information.

Source: Call Report and FR Y-9C.

**Figure 4. Deposits growth (seasonally adjusted, annual rate)**




Note: Growth rate is annualized month-over-month change, based on estimated weekly aggregate balance sheets for all commercial banks in the United States.

Source: H.8, "Assets and Liabilities of Commercial Banks in the United States."

large banks (see figure C, box 2 later in the report). Capital ratios remain well above regulatory requirements at nearly all banks, providing a buffer to support further lending. Recent regulatory changes, such as the transition period for the impact of the current expected credit losses (CECL) accounting standard, have also benefited capital ratios at some banks.[3]

## *Liquidity conditions remain strong.*

Bank deposits grew at extraordinary rates through June, as investors continued to favor safe assets and consumers increased savings (figure 4). Total deposits for all commercial banks increased by roughly $2.5 trillion between the end of 2019 and September 2020. Liquid assets as a share of total assets for the industry have risen noticeably this year (figure 5), with the majority of the increase occurring in the second quarter. Large banks have consistently remained above their liquidity coverage ratios throughout the COVID event.

**Figure 5. Liquid assets as a share of total assets**


Note: Liquid assets are cash plus estimates of securities that qualify as high-quality liquid assets (HQLA) as defined by the liquidity coverage ratio requirement. See the data appendix for further information.

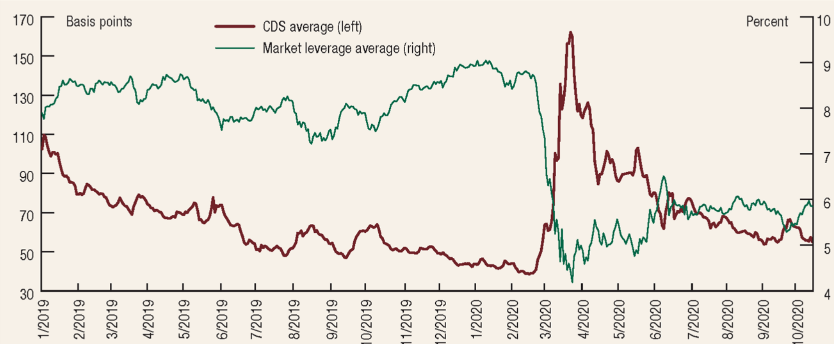
Source: FR Y-9C.

[3] The CECL transition provisions allowed firms to add back 40 basis points to the aggregate CET1 ratio through second quarter 2020.

### *Key market indicators reflect improved conditions.*

Current market-based indicators of bank health, including credit default swap (CDS) spreads and market leverage ratios, reflect stabilization in financial markets and demonstrate continued resilience of the banking system. Although both CDS spreads and market leverage ratios deteriorated sharply in the first quarter, they have not reached the extremes of the 2008 financial crisis. Both indicators began to recover in April and have generally shown improved or stable trends through the third quarter (figure 6).

**Figure 6. Average credit default swap (CDS) spread and market leverage ratio, 2019–20 (daily)**




Note: The market leverage ratio is the ratio of the firm's market capitalization to the sum of market capitalization and the book value of liabilities. Averages are calculated from available observations for the eight U.S. LISCC firms and three LISCC FBOs (U.S.: Bank of America Corporation; The Bank of New York Mellon Corporation; Citigroup Inc.; The Goldman Sachs Group; JPMorgan Chase & Co.; Morgan Stanley; State Street Corporation; and Wells Fargo & Company. FBO: Barclays PLC; Credit Suisse Group AG; and Deutsche Bank AG.)

Source: Bloomberg.

## Conditions Have Stabilized, but Uncertainty Persists

While economic activity has picked up and economic indicators have shown marked improvement since the second quarter, a high degree of uncertainty persists. Loan modifications and other policy measures make it challenging to accurately estimate potential loan losses, and macroeconomic uncertainty further complicates the analysis.

### *While measures of asset quality are relatively stable, recent loan modification activity may obscure credit quality issues.*

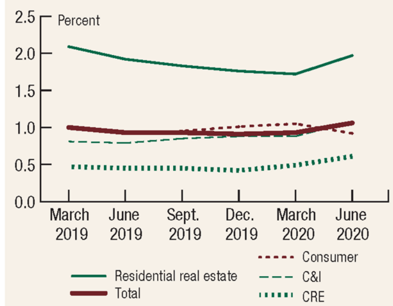
Banks have implemented loan modification programs consistent with section 4013 of the Coronavirus Aid, Relief, and Economic Security Act and have offered other accommodations to borrowers.[4] By changing the terms of a loan to make it more affordable, these programs

[4] Section 4013 of the CARES Act encourages financial institutions to work with borrowers whose ability to repay has been adversely impacted by COVID-19. Under section 4013, there is no limitation on the length of deferral periods or number of loan modifications that can be made during the applicable period. The Federal Reserve and the other federal banking agencies have also encouraged banks to work prudently with borrowers affected by COVID event containment measures. See "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)," news release, April 7, 2020, https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20200407a1.pdf.

help borrowers deal with temporary economic hardship caused by the COVID event. As discussed in more detail later in this report, the use of these programs by borrowers is lending additional support to the economic recovery.

Historically, bank asset quality rises and falls with the state of the economy. However, current measures of asset quality, such as the ratio of nonperforming loans (NPL) to total loans and leases (the NPL ratio), remain stable, even though unemployment is at a high level. The overall NPL ratio remains near its pre-COVID-event level, rising only slightly to 1.1 percent in the second quarter from 0.9 percent at the end of 2019 (figure 7). The NPL ratio for consumer loans actually decreased by 0.1 percent over this period. NPL ratios for residential real estate, commercial real estate (CRE), and C&I loans each rose slightly in the first half of 2020.

**Figure 7. Nonperforming loan ratio**




Note: Nonperforming loan ratio is the ratio of loans 90 days or more delinquent and nonaccrual loans to total loans and leases.

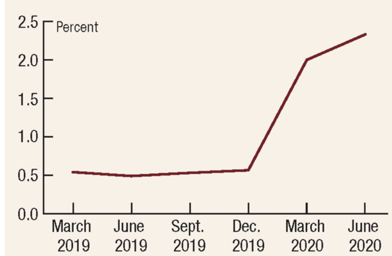
Source: Call Report and FR Y-9C.

The prevalence of loan modification programs may obscure credit quality issues, as a loan is typically not counted as "nonperforming" while it is covered by a loan modification program. When the deferral period under a loan modification program ends, many borrowers will be able to resume contractual payments; however, other borrowers may be unable to fully meet their obligations.[5] Banks will likely see an increase in nonperforming loans once deferral periods expire.

## *Higher provisions and reserves reflect concerns over potential credit losses.*

While the level of nonperforming loans remains low, banks have increased their loan loss reserves and tightened lending standards through the first half of the year in anticipation of a future rise in credit losses. Loan loss provisions as a share of average loans and leases rose sharply in the first quarter, as banks aggressively downgraded their economic forecasts. In the second quarter, as economic conditions stabilized, banks continued to increase provisions, albeit at a slower rate (figure 8). Higher reserves put banks in a stronger position to deal with any future deterioration in asset quality. As discussed in box 2 later in the report, large firms recorded

**Figure 8. Provisions to average loans and leases (annual rate)**




Source: Call Report and FR Y-9C.

[5] See SR Letter 20-18/CA 20-13 "Joint Statement on Additional Loan Accommodations Related to COVID-19" at https://www.federalreserve.gov/supervisionreg/srletters/SR2018.htm.

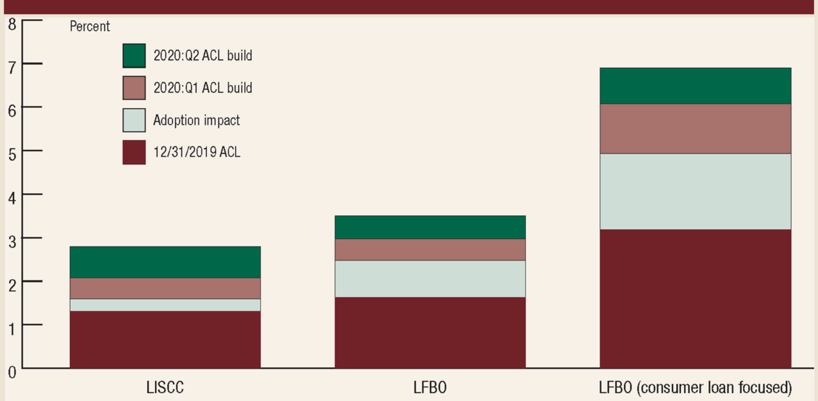
## Box 1. Reserving Practices and Trends at Firms Adopting CECL

In 2016, the Financial Accounting Standards Board (FASB) issued the current expected credit losses (CECL) methodology, a new standard that significantly revised accounting for credit losses.[1] Under CECL, the allowance for credit losses (ACL) measures a bank's lifetime expected credit losses, rather than merely near-term expected losses. To estimate those losses, institutions use a broader range of data than under the previous accounting standard. Data include information about past events, current conditions, and reasonable and supportable forecasts of future conditions. In sum, CECL requires a forward-looking approach to reserving.

Approximately 175 banking organizations adopted the CECL methodology in January 2020. As shown in figure A, those firms generally reported increases in reserves in 2020 because of the adoption of CECL at the beginning of the year and from increased reserves in both the first and second quarters. Increased reserves are not only related to the adoption of CECL, but also to rising expectations of credit risk and uncertainty in economic forecasts related to the COVID event. Increases generally occurred in both consumer and commercial loan portfolios. The most affected commercial loan sectors were oil and gas, auto, travel, and retail.

Banks have reported several challenges in implementing CECL during the COVID event. For example, the impact of government stimulus programs for consumers and businesses on credit risk is uncertain, especially as some stimulus programs are ending. In addition,

**Figure A. Portfolio comparison ACL coverage ratio, 12/31/2019–6/30/2020**




Note: ACL coverage ratio is ACL/loans. See the data appendix for further information on sampled firms. Key identifies bars in order from top to bottom.
Source: S&P Global Market Intelligence.

*(continued)*

[1] The CECL methodology is codified in FASB Accounting Standards Codification (ASC) Topic 326, Financial Instruments—Credit Losses.

## Box 1. Reserving Practices and Trends at Firms Adopting CECL *—continued*

loan modifications under the CARES Act or other modifications offered by financial institutions are challenging to reflect in CECL reserves. Finally, macroeconomic uncertainty and modeling uncertainty also pose challenges.

Federal Reserve supervisors will continue to conduct examinations of CECL implementation at large state member banks during the second half of 2020. Supervisors have focused on CECL modeling approaches, qualitative adjustments, and documentation of reserving practices. Supervisors will continue to monitor reserve levels, macroeconomic forecast assumptions, qualitative reserves, and reserve treatment for loans in loan modification programs.

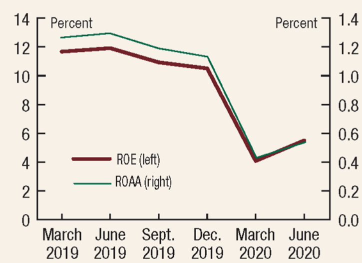
In light of the COVID event, the Board, along with the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation (FDIC), has provided firms with the option to mitigate the impact of CECL on regulatory capital for a transition period of up to five years.

declines in loss provisions in the third quarter, suggesting some confidence that the current levels of reserves can cover future deterioration in asset quality.

### *Profitability fell sharply in the first two quarters of 2020.*

Bank profitability, as measured by return on equity (ROE) and return on average assets (ROAA), fell sharply in the first quarter of 2020, driven by falling net interest income and elevated provision expenses across both corporate and consumer loans. ROE and ROAA both began to recover in the second quarter (figure 9) but have remained under pressure. Net interest margins also experienced large declines in the first half of 2020 because of lower interest rates and higher holdings of low-yield assets. Growth in trading and investment banking revenues and mortgage origination fees helped offset some of these declines. Banks participating in the PPP have reported interest and noninterest income attributable to PPP loans, which will continue to influence banks' earnings in coming quarters, particularly for community and regional banks.

**Figure 9. Bank profitability**




Note: ROE is net income/average equity capital, and ROAA is net income/average assets.

Source: Call Report and FR Y-9C.

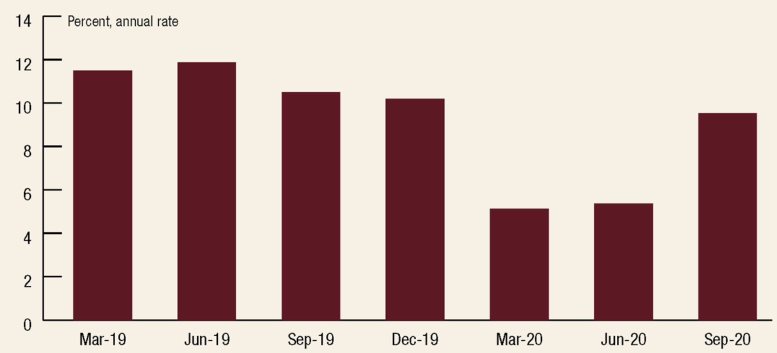
## Box 2. Third-Quarter Earnings at a Sample of Large Banks

This box provides a preliminary update on third-quarter banking sector conditions, based on early reporting by a sample of large banks that reported third-quarter earnings on or before October 16 (reporting banks).[1] While such trends are indicative, it should be noted that early reporters are not necessarily representative of the banking sector as a whole.

### Third-Quarter Earnings Improved Because of Lower Provisions

Preliminary third-quarter earnings data suggest large banks improved earnings relative to the first two quarters of 2020, predominantly because of lower loan loss provisions. Bank profitability, as measured by return on equity (ROE), increased from 5 percent in the first half of 2020 to 10 percent in the third quarter for the sample, nearing levels earned in the prior year period (figure A).

Figure A. Return on equity




Source: S&P Global Market Intelligence and earnings releases.

In the third quarter, the level of nonperforming loans rose modestly, and reporting banks limited additional increases in their loan loss reserves (figure B). Reporting banks generally expressed confidence that current reserve levels would be sufficient to deal with future deterioration in asset quality given the current economic outlook, but acknowledged that the path of the economic recovery and ultimate magnitude and timing of loan losses remain uncertain.

### Pressure on Net Revenue

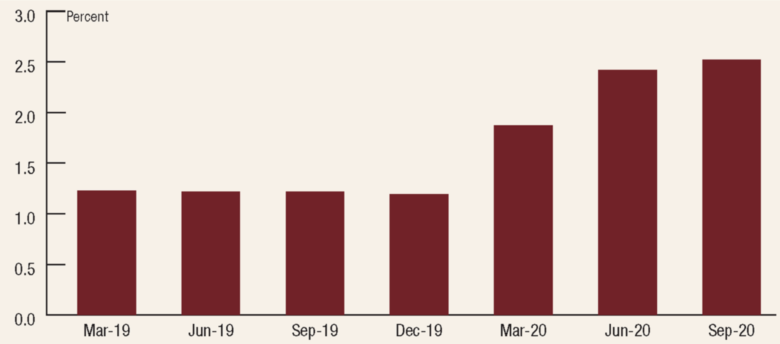
Net interest income declined 4 percent quarter-over-quarter. Declines in net interest income were due to lower interest rates and slowed loan growth, which turned negative quarter-over-quarter for the reporting banks. Noninterest income also declined on

*(continued)*

[1] Ally Financial Inc., Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., Citizens Financial Group, Inc., The Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley, The PNC Financial Services Group, Inc., State Street Corporation, Truist Financial Corporation, U.S. Bancorp, and Wells Fargo & Company.

## Box 2. Third-Quarter Earnings at a Sample of Large Banks—*continued*

**Figure B. Loan loss reserves as a percent of average loans**



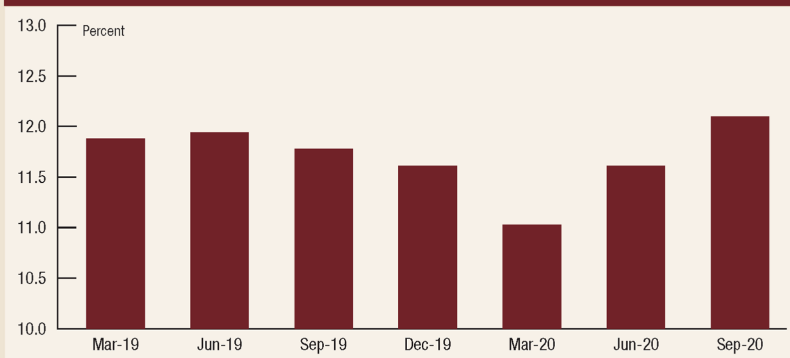

Note: See the data appendix for additional information.
Source: S&P Global Market Intelligence and earnings releases.

aggregate quarter-over-quarter (−10 percent), as sales and trading and investment banking earnings were strong but declined relative to the record-setting previous quarter.

### Improved Capital Ratios

During the quarter, reporting banks accreted common equity tier 1 (CET1) capital and improved their capital ratios (figure C). This continues the trend seen in the second quarter, as earnings offset dividends paid, and as banks continued suspensions of share repurchases. Declines in risk-weighted assets, driven in part by slower loan demand and tighter lending standards, also contributed to the rise in CET1 capital ratios. The aggregate CET1 ratio for the reporting banks ended the third quarter near 12 percent, above its level at the start of 2020.

**Figure C. CET1 ratio**




Source: S&P Global Market Intelligence and earnings releases.

# Regulatory Developments

The Federal Reserve continues to support the flow of credit to help underpin economic recovery. The *Supervision and Regulation Report, May 2020* summarized the numerous regulations and policy statements that were issued at the beginning of the COVID event. Since that time, the Federal Reserve has undertaken further COVID-related actions to support the flow of credit and liquidity and to ease operational burden for banking organizations. Some of these actions extended or expanded prior measures, including temporarily adjusting the supplementary leverage ratio requirements for depository institutions and continuing to support Federal Reserve credit facilities created during the COVID event. The Federal Reserve also completed regulatory and policy actions not related to the COVID event, detailed below (table 1).

While this report is focused on safety and soundness initiatives, it is also important to note that on September 21, 2020, the Board issued an Advance Notice of Proposed Rulemaking to modernize the regulations to implement the Community Reinvestment Act with a 120-day comment period.[6]

[6] See Board of Governors of the Federal Reserve System, "Federal Reserve Board Issues Advance Notice of Proposed Rulemaking on an Approach to Modernize Regulations That Implement the Community Reinvestment Act," news release, September 21, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm.

**Table 1. Federal Reserve or interagency rulemakings/statements (proposed and final)**
**From 10/1/2019 to 10/30/2020**
***Entries in bold and italic indicate regulation or guidance related to the COVID event.***

| Date issued | Rule/guidance |
|---|---|
| 10/2/2019 | Agencies issue final rule to update management interlock rules.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191002a.htm |
| 10/8/2019 | Agencies finalize changes to simplify Volcker rule proprietary trading regulations.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191008a.htm |
| 10/10/2019 | Federal Reserve Board finalizes rules that tailor its regulations for domestic and foreign banks to more closely match their risk profiles.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm |
| 10/17/2019 | Federal Reserve Board releases results of survey of senior financial officers at banks about their strategies and practices for managing reserve balances.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/other20191017a.htm |
| 10/18/2019 | FDIC and Federal Reserve request information on use and impact of CAMELS ratings.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191018a.htm |
| 10/28/2019 | Agencies propose rule to amend swap margin rules.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191028a.htm |

*(continued)*

**Table 1.**—*continued*

| Date issued | Rule/guidance |
|---|---|
| 10/28/2019 | Agencies finalize changes to resolution plan requirements; revises requirements consistent with the tailoring rule—keeping the most stringent requirements for largest firms and reducing requirements for smaller firms.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191028b.htm |
| 10/29/2019 | Federal bank regulatory agencies issue final rule to simplify capital calculation for community banks by adopting a community bank leverage ratio option.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191029a.htm |
| 11/8/2019 | Federal Reserve Board invites public comment on proposal to extend by 18 months initial compliance dates for foreign banks subject to its single-counterparty credit limit rule.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191108a.htm |
| 11/19/2019 | Agencies finalize changes to supplementary leverage ratio as required by Economic Growth, Regulatory Relief, and Consumer Protection Act.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191119a.htm |
| 11/19/2019 | Federal bank regulatory agencies issue final rule on treatment of high volatility commercial real estate.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191119b.htm |
| 11/19/2019 | Federal bank regulatory agencies finalize rule to update calculation of counterparty credit risk for derivatives contracts.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191119c.htm |
| 12/3/2019 | Agencies clarify requirements for providing financial services to hemp-related businesses.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191203a.htm |
| 12/12/2019 | Federal Reserve Board announces annual adjustment to the asset-size threshold in Regulation I regarding dividend rate paid to member banks.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191212a.htm |
| 12/13/2019 | Federal Reserve Board announces it will extend until January 22, 2020, comment period for its proposal to establish risk-based capital requirements for certain insurance companies supervised by the Board.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191213a.htm |
| 12/17/2019 | Agencies find no deficiencies in resolution plans from the largest banks; find shortcomings for several firms.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191217a.htm |
| 1/30/2020 | Federal Reserve Board finalizes rule to simplify and increase the transparency of the Board's rules for determining control of a banking organization.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200130a.htm |
| 1/30/2020 | Agencies propose changes to modify Volcker rule "covered funds" restrictions.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200130b.htm |
| 3/4/2020 | Federal Reserve Board approves rule to simplify its capital rules for large banks, preserving the strong capital requirements already in place.<br>Federal Reserve Board press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm |
| 3/6/2020 | Agencies invite comment on updates to resolution plan guidance for large foreign banks.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200306b.htm |

*(continued)*

**Table 1.**—*continued*

| Date issued | Rule/guidance |
|---|---|
| ***3/9/2020*** | ***Agencies encourage financial institutions to meet financial needs of customers and members affected by coronavirus.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200309a.htm*** |
| ***3/10/2020*** | ***SR 20-3 / CA 20-2 Interagency Statement on Pandemic Planning:***<br>***https://www.federalreserve.gov/supervisionreg/srletters/SR2003.htm*** |
| ***3/13/2020*** | ***SR 20-4 / CA 20-3 Supervisory Practices Regarding Financial Institutions Affected by Coronavirus:***<br>***https://www.federalreserve.gov/supervisionreg/srletters/SR2004.htm*** |
| ***3/22/2020*** | ***Agencies provide additional information to encourage financial institutions to work with borrowers affected by COVID-19.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200322a.htm*** |
| ***3/24/2020*** | ***Federal Reserve provides additional information to financial institutions on how its supervisory approach is adjusting in light of the coronavirus.***<br>***Federal Reserve Board press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200324a.htm*** |
| ***3/25/2020*** | ***The Federal Financial Institutions Examination Council (FFIEC) on behalf of its members issued a statement highlighting coordination and collaboration of efforts to address COVID-19.***<br>***FFIEC press release:***<br>***https://www.ffiec.gov/press/pr032520.htm*** |
| ***3/26/2020*** | ***Federal agencies encourage banks, savings associations and credit unions to offer responsible small-dollar loans to consumers and small businesses affected by COVID-19***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200326a.htm*** |
| ***3/30/2020 & 4/2/2020*** | ***SR 20-8 Joint Statement on Adjustment to the Calculation for Credit Concentration Ratios Used in the Supervisory Approach:***<br>***https://www.federalreserve.gov/supervisionreg/srletters/SR2008.htm*** |
| ***4/6/2020*** | ***Agencies announce changes to the community bank leverage ratio.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm*** |
| ***4/6/2020*** | **SR 20-10 Small Business Administration (SBA) and Treasury Small Business Loan Programs:**<br>**https://www.federalreserve.gov/supervisionreg/srletters/SR2010.htm** |
| ***4/7/2020*** | ***Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised).***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200407a.htm*** |
| 4/15/2020 | SR 20-11 Release of Updated Sections of the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual:<br>https://www.federalreserve.gov/supervisionreg/srletters/SR2011.htm |
| ***4/17/2020*** | ***Federal Reserve adopts a change in Regulation O to temporarily modify the Board's rules so that certain bank directors and shareholders can apply to their banks for a Small Business Administration's Paycheck Protection Program loan.***<br>***Federal Reserve Board press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200417a.htm*** |
| ***4/27/2020*** | ***Agencies extend comment period on updates to resolution plan guidance for large foreign banks.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200427a.htm*** |
| 4/30/2020 | The FFIEC on behalf of its members issued a statement to address the use of cloud computing services and security risk management principles in the financial services sector.<br>FFIEC press release:<br>https://www.ffiec.gov/press/pr043020.htm |

*(continued)*

**Table 1.—*continued***

| Date issued | Rule/guidance |
|---|---|
| ***5/1/2020*** | ***Federal Reserve Board finalizes rule to extend by 18 months the initial compliance dates for certain parts of its single-counterparty credit limit rule.***<br>***Federal Reserve Board press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200501a.htm*** |
| ***5/5/2020*** | ***Federal bank regulatory agencies modified the liquidity coverage ratio for banks participating in Money Market Mutual Fund Liquidity Facility and Paycheck Protection Program Liquidity Facility.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200505a.htm*** |
| ***5/8/2020*** | ***Federal financial regulatory agencies issue interagency policy statement on allowances for credit losses and interagency guidance on credit risk review systems.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200508a.htm*** |
| 5/8/2020 | SR 20-12 Interagency Policy Statement on Allowances for Credit Losses:<br>https://www.federalreserve.gov/supervisionreg/srletters/SR2012.htm |
| 5/8/2020 | SR 20-13 Interagency Guidance on Credit Risk Review Systems:<br>https://www.federalreserve.gov/supervisionreg/srletters/SR2013.htm |
| ***5/15/2020*** | ***Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm*** |
| ***5/20/2020*** | ***Federal agencies share principles for offering responsible small-dollar loans, including during periods of economic stress, natural disasters, or other extraordinary circumstances such as the public health emergency created by COVID-19.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200520a.htm*** |
| ***6/15/2020*** | ***Federal Reserve Board resumes examination activities for all banks, after previously announcing a reduced focus on exam activity in light of the coronavirus response.***<br>***Federal Reserve Board press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm*** |
| ***6/23/2020*** | ***Federal and state regulatory agencies issue examiner guidance for assessing safety and soundness considering the effect of the COVID-19 pandemic on financial institutions.***<br>***Interagency press release:***<br>***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200623a.htm*** |
| ***6/23/2020*** | ***SR 20-15 Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions:***<br>***https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm*** |
| 6/24/2020 | SR 20-16 Supervision of De Novo State Member Banks:<br>https://www.federalreserve.gov/supervisionreg/srletters/SR2016.htm |
| 6/25/2020 | Financial regulators modify provisions of Volcker rule related to "covered funds."<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm |
| 6/25/2020 | Agencies finalize amendments to swap margin rule.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625b.htm |
| 7/1/2020 | Agencies provide largest firms with information for next resolution plans.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200701a.htm |
| 7/1/2020 | Financial regulators issue statement on managing the LIBOR transition.<br>FFIEC press release:<br>https://www.ffiec.gov/press/pr070120.htm |

*(continued)*

**Table 1.—***continued*

| Date issued | Rule/guidance |
|---|---|
| ***7/15/2020*** | ***Federal Reserve extends a change in Regulation O to temporarily modify the Board's rules so that certain bank directors and shareholders can apply to their banks for a Small Business Administration's Paycheck Protection Program loan.*** <br> ***Federal Reserve Board press release:*** <br> ***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200715a.htm*** |
| ***8/3/2020*** | ***SR 20-18 / CA 20-13 Joint Statement on Additional Loan Accommodations Related to COVID-19:*** <br> ***https://www.federalreserve.gov/supervisionreg/srletters/SR2018.htm*** |
| 8/21/2020 | SR 20-21 Joint Statement on Bank Secrecy Act Due Diligence Requirements for Customers Who May Be Considered Politically Exposed Persons: <br> https://www.federalreserve.gov/supervisionreg/srletters/SR2021.htm |
| ***8/26/2020*** | ***Agencies issue three final rules:*** <br> • ***a final rule that temporarily modifies the community bank leverage ratio, as required by the CARES Act;*** <br> • ***a final rule that makes more gradual, as intended, the automatic restrictions on distributions if a banking organization's capital levels decline below certain levels; and*** <br> • ***a final rule that allows institutions that adopt the current expected credit losses, or "CECL," accounting standard in 2020 to mitigate the estimated effects of CECL on regulatory capital for two years.*** <br> ***Interagency press release:*** <br> ***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200826a.htm*** |
| 9/1/2020 | Federal and state financial regulatory agencies issue interagency statement on supervisory practices regarding financial institutions affected by Hurricane Laura and California wildfires. <br> Interagency press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200901b.htm |
| 9/21/2020 | The Federal Reserve Board issued an Advance Notice of Proposed Rulemaking to modernize the regulations to implement the Community Reinvestment Act. <br> Federal Reserve Board press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm |
| ***9/29/2020*** | ***Agencies issue two final rules:*** <br> • ***a final rule that temporarily defers appraisal and evaluation requirements for up to 120 days after the closing of certain residential and commercial real estate transactions;*** <br> • ***a final rule that neutralizes—because of the lack of credit and market risk—the regulatory capital and liquidity effects for banks that participate in certain Federal Reserve liquidity facilities.*** <br> ***Interagency press release:*** <br> ***https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200929a.htm*** |
| 9/30/2020 | Federal Reserve Board invites public comment on proposal to update the Board's capital planning requirements to be consistent with other Board rules that were recently modified. <br> Federal Reserve Board press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930a.htm |
| 10/9/2020 | SR 20-22 ISDA IBOR Fallback Protocol and IBOR Fallback Supplement: <br> https://www.federalreserve.gov/supervisionreg/srletters/SR2022.htm |
| 10/9/2020 | SR 20-23 Interagency Order Granting an Exemption from Customer Identification Program Requirements for Loans Extended by Banks and Their Subsidiaries to All Customers to Facilitate Purchases of Property and Casualty Insurance Policies: <br> https://www.federalreserve.gov/supervisionreg/srletters/SR2023.htm |
| 10/20/2020 | The federal banking agencies issued a final rule to strengthen resilience of large banks by requiring them to maintain a minimum level of stable funding over a one-year period. <br> Interagency press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020b.htm |
| 10/20/2020 | The federal banking agencies finalized a rule to limit the interconnectedness and reduce the impact from failure of the largest banking organizations. <br> Interagency press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020a.htm |
| 10/23/2020 | The Federal Reserve Board and the Financial Crimes Enforcement Network (FinCEN) issued for public comment a proposed rule that would amend the recordkeeping and travel rule regulations under the Bank Secrecy Act. <br> Interagency press release: <br> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201023a.htm |

*(continued)*

**Table 1.**—*continued*

| Date issued | Rule/guidance |
|---|---|
| 10/29/2020 | Agencies propose regulation on the role of supervisory guidance.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201029a.htm |
| 10/30/2020 | Agencies release paper on operational resilience.<br>Interagency press release:<br>https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201030a.htm |

# Supervisory Developments

## Overview

This section provides an overview of key developments related to the Federal Reserve's prudential supervision of financial institutions, including large financial institutions (known as LISCC firms and LFBO firms) as well as community and regional banking organizations (known as CBOs and RBOs). Table 2 provides an overview of the organizations supervised by the Federal Reserve, by portfolio, including the number of institutions and total assets in each portfolio.

**Table 2. Summary of organizations supervised by the Federal Reserve (as of 2020:Q2)**

| Portfolio | Definition | Number of institutions | Total assets ($trillions) |
| --- | --- | --- | --- |
| **Large Institution Supervision Coordinating Committee (LISCC)** | Eight U.S. global systematically important banks (G-SIBs) and three foreign banking organizations | 11 | 13.8 |
| State member banks (SMBs) | SMBs within LISCC organizations | 5 | 1.0 |
| **Large and foreign banking organizations (LFBOs)** | Non-LISCC U.S. firms with total assets $100 billion and greater and non-LISCC FBOs | 175 | 8.5 |
| Large banking organizations (LBOs) | Non-LISCC U.S. firms with total assets $100 billion and greater | 16 | 4.0 |
| Large FBOs | Non-LISCC FBOs with combined U.S. assets $100 billion and greater | 15 | 3.3 |
| Small FBOs | FBOs with combined U.S. assets less than $100 billion | 144 | 1.1 |
| State member banks | SMBs within LFBO organizations | 8 | 1.0 |
| **Regional banking organizations (RBOs)** | Total assets between $10 billion and $100 billion | 88 | 2.5 |
| State member banks | SMBs within RBO organizations | 40 | 0.8 |
| **Community banking organizations (CBOs)** | Total assets less than $10 billion | 3,734* | 2.7 |
| State member banks | SMBs within CBO organizations | 685 | 0.5 |
| **Insurance and commercial savings and loan holding companies (SLHCs)** | SLHCs primarily engaged in insurance or commercial activities | 8 insurance<br>4 commercial | 1.1 |

* Includes 3,673 holding companies and 61 state member banks that do not have holding companies.

Source: Call Report, FFIEC 002, FR 2320, FR Y-7Q, FR Y-9C, FR Y-9SP, and S&P Global Market Intelligence.

The Federal Reserve also has responsibility for certain laws and regulations relating to consumer protection and community reinvestment. The scope of the Federal Reserve's supervisory jurisdiction varies based on the particular law or regulation and on the asset size of the state member bank. Consumer-focused supervisory work is designed to promote a fair and transparent financial services marketplace and to ensure that the financial institutions under the Federal Reserve's jurisdiction comply with applicable federal consumer protection laws and regulations.

More information about the Federal Reserve's consumer-focused supervisory program can be found in the Federal Reserve's 106th *Annual Report 2019*.[7] The Federal Reserve also publishes the *Consumer Compliance Supervision Bulletin*, which shares information about examiners' supervisory observations and other noteworthy developments related to consumer protection.[8]

### *Federal Reserve supervision responded quickly to the current crisis.*

The Federal Reserve promotes a safe, sound, and efficient banking system and a fair and transparent consumer financial services marketplace that supports the growth and financial stability of the U.S. economy. In response to the disruptions posed by the COVID event, Federal Reserve supervisors have focused on ensuring that financial institutions can meet the challenges faced by their customers and local communities.

In June 2020, the Federal Reserve, along with the FDIC, OCC, National Credit Union Association, and Conference of State Bank Supervisors, issued guidance to promote consistency in the supervision and examination of financial institutions affected by the COVID event.[9] The interagency guidance acknowledges that the stresses caused by the COVID event can affect a bank's financial condition and operational capabilities, even when the bank has appropriate governance and risk-management systems in place. The guidance instructs safety and soundness examiners to consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and to exercise appropriate flexibility in their supervisory response. In assessing the safety and soundness of an institution, examiners will consider the institution's asset size, complexity, and risk profile, as well as the industry and business focus of its customers.

### *The Federal Reserve has resumed examinations following a pause.*

Examination activities help the Federal Reserve understand the safety and soundness of each institution and assess its compliance with applicable laws and regulations, including those related to consumer protection.

At the start of the COVID event, the Federal Reserve temporarily adjusted its supervisory approach. From late-March to mid-June, examiners focused on monitoring and reduced examination activities, with the greatest reduction occurring at the smallest banks. The Federal Reserve's supervisory approach gave firms time to adapt to the COVID event and provide customers with needed assistance. Financial institutions implemented contingency operating plans and adapted operations to the new environment. In June, examination activities resumed for all firms. All examination activities, including full scope examinations, will be conducted off-site until local conditions improve to facilitate on-site examinations.

The Federal Reserve recognizes that the current situation significantly affects institutions and communities in different ways and will work with financial institutions to understand specific issues as it engages in supervisory activities. Financial institutions supervised by the Federal

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7 See 106th *Annual Report 2019*, section 5, "Consumer and Community Affairs," at https://www.federalreserve.gov/publications/annual-report.htm.

8 See the *Consumer Compliance Supervision Bulletin*, December 2019 at https://www.federalreserve.gov/publications/2019-december-consumer-compliance-supervision-bulletin.htm.

9 SR Letter 20-15, "Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm.

Reserve should work directly with their Reserve Bank and state banking agencies, as applicable, if they have questions on planned supervisory activities.

## Supervised Institutions

The Federal Reserve follows a risk-focused approach by scaling its supervisory work to the size and complexity of an institution. In supervising financial institutions, a risk-focused approach to supervision is more efficient and results in more rigorous oversight of firms that pose increased risk to the financial system.

Firms identified as posing elevated risk to U.S. financial stability are supervised by the Large Institution Supervision Coordinating Committee, or LISCC, program. The LISCC program is a national program that uses both cross-firm (horizontal) and firm-specific supervisory activities to assess the financial resiliency and risk-management practices of firms. The list of firms in the LISCC portfolio is updated from time to time in light of developments at firms and in the financial sector. During the period covered by this report, the LISCC portfolio included eight domestic firms and three foreign banking organizations.

The Large and Foreign Banking Organization, or LFBO, program supervises all other large financial institutions that are not included in the LISCC program. The LFBO program includes some cross-firm supervisory activities, but firm-specific teams at the local Reserve Bank conduct most of the supervisory work, subject to oversight by the Board.

### Box 3. Supervision in a Remote Environment

Federal Reserve examiners have been conducting supervision using remote arrangements since the start of the COVID event and are well prepared to continue to operate in the remote environment. Over the past few years, the Federal Reserve has conducted much of its examination activity for smaller institutions from Federal Reserve offices, rather than on-site at the supervised institution. For instance, examiners can review loans through a secure transfer of an institution's loan files. In addition to saving travel time and expense, off-site examination activity reduces the impact on an institution's normal business operations that can occur when examiners are on-site. Therefore, when many institutions closed their offices because of the COVID event, examiners were still able to conduct work effectively and reach appropriate examination findings and conclusions.

Further, examination processes have been streamlined and adjusted to operate in a remote working environment and to provide greater agility and efficiency in conducting supervisory assessments. There have been minor logistical challenges reported when conducting entire examinations in an off-site format. In these few cases, the Reserve Banks provided flexibility and successfully worked through the technical issues with the supervised institutions.

Firms with assets less than $100 billion are supervised by the community banking organization, or CBO, and regional banking organization, or RBO, programs.[10] For CBOs and RBOs,

[10] Community banking organizations have less than $10 billion in total assets, and regional banking organizations have total assets between $10 billion and $100 billion.

the supervision model is more decentralized than the LISCC and the LFBO programs, with greater decisionmaking flexibility provided to Reserve Banks; again, subject to oversight by Board staff.

## Large Financial Institutions

This section of the report discusses the supervisory approach for large financial institutions, which are U.S. firms with assets of $100 billion or more and foreign banking organizations with combined U.S. assets of $100 billion or more. These firms are within either the LISCC portfolio or the LFBO portfolio. Large financial institutions are subject to regulatory requirements that are tailored to the risk profiles of these firms. Box 4 provides an overview of these regulatory requirements.

### *Large financial institutions remain well capitalized.*

Federal Reserve supervision helps to ensure that large financial institutions remain financially resilient, so that they can meet their obligations to creditors and other counterparties and continue to lend through a range of conditions. Large financial institutions remain well capitalized and able to support lending, although the COVID event has introduced significant financial uncertainty for the banking industry. The aggregate CET1 capital ratio for large banks in the second quarter was 12.2 percent, a similar level to the end of 2019, despite rising provisions and a slowdown in economic activity.[11] As discussed earlier in box 2, preliminary earnings data show an increase in the CET1 ratio in the third quarter of 2020. The improvement in capital ratios has been supported by the rebound in earnings, and in part by the capital conservation measures discussed below.

### *Stress testing is a cornerstone of Federal Reserve oversight.*

Since the 2008 financial crisis, the Federal Reserve has taken action to improve the quantity and quality of capital in the banking system. Stress testing is a critical tool to assess overall financial resilience of large banks. For firms with $100 billion or more in total assets, the Federal Reserve conducts a stress test to measure the resiliency of their capital under hypothetical stress scenarios and to verify that banks are prepared to deal with severe economic and financial conditions.[12] Starting this year, the results of the same stress test will also be used to set the stress capital buffer requirements for large banks.[13]

The unusual nature of the current crisis has made it particularly difficult to predict near-term trends. Given this ongoing uncertainty, the Board conducted a sensitivity analysis earlier this year, in addition to its normal stress test, to assess the resiliency of large banks under three

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[11] Large banks include all bank holding companies and intermediate holding companies with $100 billion or more in assets.

[12] The sensitivity analysis includes the 33 firms. It does not include all large financial institutions (LFI) firms. The list of participating firms is available here: https://www.federalreserve.gov/publications/files/2020-sensitivity-analysis-20200625.pdf.

[13] In March, the Board adopted a final rule to integrate its capital planning and regulatory capital requirements through the establishment of a stress capital buffer requirement, creating a single, risk-sensitive capital framework for LBOs. The stress capital buffer requirement is calculated as the maximum decline in a firm's CET1 capital ratio over the supervisory stress test planning horizon plus four quarters of planned common stock dividends. See 85 Fed. Reg. 15,576 (March 18, 2020).

## Box 4. Tailoring of Regulation

In October 2019, the Board adopted rules that tailor its regulations for domestic and foreign banks to more closely match their risk profiles.[1] The rules establish a framework that sorts banks with $100 billion or more in total assets into four categories based on several factors, including asset size, cross-jurisdictional activity, reliance on weighted short-term wholesale funding (wSTWF), nonbank assets (NBA), and off-balance-sheet exposure (table A). (Some firms appear in the table twice as standards vary by legal entity.) Significant levels of these factors result in risk and complexity to a bank and can in turn bring risk to the financial system and broader economy. As the risk of a firm increases and it moves into a new risk category, its requirements will increase.

**Table A. List of domestic and foreign firms, by category, as of 2020:Q2**

| | Category I<br>U.S. G-SIBs | Category II<br>≥$700b total assets or ≥$75b in cross-jurisdictional activity | Category III<br>≥$250b total assets or ≥$75b in NBA, wSTWF, or off-balance-sheet exposure | Category IV<br>Other firms with $100b to $250b total assets |
|---|---|---|---|---|
| **Domestic firms** | | | | |
| U.S. domestic banking organization | Bank of America<br>Bank of New York Mellon<br>Citigroup<br>Goldman Sachs<br>JPMorgan Chase<br>Morgan Stanley<br>State Street<br>Wells Fargo | Northern Trust | Capital One<br>Charles Schwab<br>PNC Financial<br>U.S. Bancorp<br>Truist Financial | Ally Financial<br>American Express<br>Citizens Financial<br>Discover<br>Fifth Third<br>Huntington<br>KeyCorp<br>M&T Bank<br>Regions Financial<br>Synchrony Financial |
| **Foreign firms (standards vary by legal entity)** | | | | |
| Intermediate holding company | | | Barclays US<br>Credit Suisse USA<br>Deutsche Bank USA<br>DWS USA<br>HSBC North America<br>TD Group US<br>UBS Americas | BMO Financial<br>BNP Paribas USA<br>MUFG Americas<br>RBC US<br>Santander Holdings USA |
| Combined U.S. operations | | Barclays<br>Credit Suisse<br>Deutsche Bank<br>MUFG<br>Sumitomo Mitsui | Bank of Montreal<br>BNP Paribas<br>HSBC<br>Mizuho<br>Toronto-Dominion<br>UBS | Banco Santander<br>Bank of Nova Scotia<br>BBVA<br>BPCE<br>Société Generalé<br>Royal Bank of Canada |

Note: NBA is nonbank assets, wSTWF is weighted short-term wholesale funding.
Source: FR Y-15, FR Y-9C, FR Y-7Q, 2019:Q3–2020:Q2.

[1] Prudential Standards for Large Bank Holding Companies, Savings and Loan Holding Companies, and Foreign Banking Organizations, https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23662.pdf.

hypothetical recessions, or downside scenarios, that could result from the COVID event.[14] The scenarios included: a V-shaped recession and recovery; a slower, U-shaped recession and recovery; and a W-shaped, double-dip recession.

In the three downside scenarios, the unemployment rate peaked at between 15.6 percent and 19.5 percent, significantly more adverse than any of the Board's pre-coronavirus stress test scenarios.

The annual stress test and sensitivity analysis generally showed that large banks are well capitalized and would remain so under a V-shaped downside scenario or an economic downturn similar in severity and duration to the last crisis. However, a delay in the economic recovery could have measurable negative effects on capital levels at many banks. Given the uncertainty surrounding recovery, the Federal Reserve took several preemptive actions for large banks to help ensure that these firms remain sufficiently capitalized.

For large banks, the Federal Reserve suspended share repurchases, capped the growth of dividends, and imposed a limit that dividends cannot exceed recent income. The distribution limitations were initially applied for the third quarter of 2020. At the end of the third quarter, given continued economic uncertainty from the COVID event, the Board extended the limitations through the end of the year.

These capital conservation measures have resulted in a preservation of capital at large banks, further allowing them to support the economic recovery.

### *The Federal Reserve is adapting its capital planning examinations.*

In response to the current macroeconomic environment, the Federal Reserve modified its annual capital planning examinations—Comprehensive Capital Analysis and Review (CCAR) and the Horizontal Capital Review (HCR)—to focus on monitoring how firms' capital planning responded to the COVID event.[15] In this year's CCAR and HCR, Federal Reserve examiners monitored how firms were managing their capital in the current environment, planning for contingencies, and positioning themselves to continue lending to creditworthy households and businesses.

The Federal Reserve's monitoring efforts have revealed certain differences in how firms adapted their capital planning to the COVID event. Firms used different forecasts of the COVID event on their capital positions. In some cases, firms relied exclusively on V-shaped scenarios rather than considering the potential for slower economic recovery. The severe macroeconomic conditions (such as the high unemployment rate arising from the crisis) and the effects of the economic stimulus and loan modification programs have been difficult for firms to incorporate into loss forecasting models. These challenges have prompted many firms to rely upon qualitative approaches, including the application of management judgment, to forecast losses and revenues. In addition, some firms have expedited their governance processes to respond to the rapidly changing situation.

[14] The scenarios are not predictions or forecasts of the likely path of the economy or financial markets.

[15] In normal cycles, as compared to CCAR's assessment of capital planning practices, HCR is more limited in scope, includes targeted horizontal evaluations of specific areas of capital planning, and focuses on the more tailored expectations set forth in supervisory guidance specific to these firms.

Because of the economic uncertainty from the COVID event, the Federal Reserve is requiring large banks to update and resubmit their capital plans in the fourth quarter to reflect the current stresses, which will help firms reassess their capital needs and maintain strong capital positions. The resubmission will also allow the Board to conduct additional analysis to further assess the financial conditions and risks of these banks and to determine if further supervisory actions are necessary.

In addition, the Board is performing another round of stress tests in the fourth quarter because of the continued uncertainty from the COVID event. Large banks will be tested against two scenarios featuring severe recessions to assess their resiliency under a range of outcomes. The Board will release firm-specific results from banks' performance under both scenarios by the end of this year.

Supervisors are monitoring credit portfolios exposed to industries materially affected by the COVID event (such as transportation and hospitality) in recognition of heightened risks that may be material loss drivers under certain economic conditions.

Supervisors are also focused on assessing

- credit-risk-management practices and loss projections for the highest risk portfolios;
- the timeliness of credit loss recognition and whether loss projections properly account for uncertainty in the current environment; and
- whether risk identification, measurement, and mitigation measures are sufficient to maintain capital adequacy under a range of adverse scenarios.

### *The COVID event has led to unprecedented action to accommodate borrowers.*

As discussed above, since the start of the COVID event, financial institutions—including large financial institutions—have accommodated borrowers in many ways, including payment deferrals, interest-only payment periods, fee waivers, forbearance, and temporary suspensions from credit reporting. The Federal Reserve and the other federal banking agencies have encouraged financial institutions to work in a prudent and safe and sound manner with borrowers who have been affected by the COVID event. Federal banking agencies view these accommodations as a positive response by institutions, which can help to manage or mitigate the adverse impact of the COVID event on their borrowers and communities.[16]

In response to the COVID event, large financial institutions have provided loan modifications on a sizable portion of their loan balances. Large financial institutions that reported on loan modification programs in their second-quarter public financial filings[17] disclosed $330 billion

[16] Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised) (April 7, 2020); see also SR Letter 20-15 and SR Letter 20-18/ CA 20-13.

[17] Firms that disclose loan modification figures in their second quarter 2020 10-Qs include: Bank of America Corporation; The Bank of New York Mellon Corporation; Capital One Financial Corporation; Citigroup Inc.; Citizens Financial Group, Inc.; Discover Financial Services; Fifth Third Bancorp; The Goldman Sachs Group, Inc.; Huntington Bancshares Incorporated; JPMorgan Chase & Co; KeyCorp; M&T Bank Corporation; Morgan Stanley; Northern Trust Corporation; The PNC Financial Services Group, Inc; Regions Financial Corporation; Truist Financial Corporation; and U.S. Bancorp.

### Box 5. Climate Change and Microprudential Risks

Federal Reserve supervisors are responsible for ensuring that supervised institutions operate in a safe and sound manner and can continue to provide financial services to their customers in the face of all types of risks, including those related to climate change.

The effects of climate change can manifest as traditional microprudential risks, including through credit, market, operational, legal, and reputational risk. For example, chronic flooding or wildfires may pose a risk to the value of the collateral that a bank has taken as security against its loans. Technological innovations in the production, storage, and transport of energy could decrease the value of assets dependent on older technologies, resulting in mark-to-market losses on bank's trading portfolios or reduced cash flow of certain borrowers. Severe weather events could damage a bank's own physical property and data centers, affecting its ability to provide financial services to its customers.

The industry is adapting governance, risk identification and management, and scenario analysis and disclosures to better account for climate-related risks. The assessment and management of climate-related risks, however, present several challenges. The time horizon used to consider the effects of climate change significantly exceeds the typical life span of bank exposures as well as typical control and planning horizons. Future relationships between climate, economic, and financial variables might differ significantly from those observed in the past. Finally, assessing the materiality of climate-related risk requires new, asset-specific or geo-spatial data that involve significant resources to acquire and process.

Supervisors will seek to better understand, measure, and mitigate climate-related financial risks, including through analysis of transmission channels of climate change risk to the banking sector, measurement methodologies, and data gaps and challenges. Supervisors will also continue to work closely with other agencies and authorities, including through the Basel Committee on Banking Supervision's Task Force on Climate-Related Financial Risks and the Financial Stability Board.

of modified loans.[18] This amount equates to approximately 6 percent of total loan balances for these firms as of the second quarter of 2020.

For consumer loans, there was an initial surge in loan modifications in March and April, followed by a significant decline, particularly for non-mortgage retail credit such as credit card loans and auto loans. The decline has been driven both by bank actions, such as tighter re-enrollment conditions, and actions by borrowers, many of whom have resumed payments on outstanding loans. Early in the COVID event, many borrowers enrolled in payment deferral programs as a precautionary measure but have exited those programs as economic conditions stabilized.

[18] There is not a standard definition of "loan modifications" within the banking industry, and the SEC has not provided guidance on how firms should report these balances on their 10-Qs. Accordingly, while publicly disclosed loan modifications indicate the magnitude of these balances, they do not provide comparable data across firms.

For commercial loans, loan modifications continued to increase in the third quarter. Industries more severely affected by the COVID event, such as hotels, hospitality, and retail, show the highest concentrations of modifications.

### *Large firms have shown operational resilience to the COVID event.*

The Federal Reserve is conducting monitoring and examination activities to understand how large financial institutions have adapted their controls and operational risk management in light of the COVID event. As a whole, large firms have been resilient, leveraging their business continuity and business resumption strategies to enable remote work, with a few notable challenges. For example, firms were required to adjust practices that traditionally require an on-site presence, such as obtaining signatures or managing lockbox operations. Many firms and their third-party service providers rapidly modified processes and controls in light of these challenges, and the processes continue to evolve.

Firms are increasingly using remote endpoints, external networks, and collaboration tools to support remote work, heightening potential vulnerabilities related to cybersecurity attacks. Ransomware attacks, especially those targeting third-party service providers, are occurring with greater frequency and increasing effectiveness. The Federal Reserve's cybersecurity monitoring effort is designed to analyze the heightened risk environment, build supervisory knowledge of cyber risks, and take appropriate supervisory actions.

### Box 6. Current Large Financial Institution Supervisory Priorities

**Capital**

- Credit risk, including credit loss recognition; loan review; and accuracy of risk-weighted assets
- Review of November 2020 capital plan resubmissions
- Earnings pressures and the ability to preserve capital in the current environment
- Board effectiveness and engagement

**Liquidity**

- Internal liquidity stress testing assumptions, liquidity data quality, and contingency funding plans
- Liquidity risk limits and related governance processes
- Daily and short-term liquidity risk management monitoring programs

**Governance and controls**

- Risk management in response to the COVID event
- Operational resilience, including cyber-related and information technology risks
- Compliance risk management, including Bank Secrecy Act/anti-money-laundering programs and OFAC compliance
- LIBOR transition preparedness

**Recovery and resolution planning**

- Resolution plan and critical operations reviews
- Recovery planning (for LISCC firms)
- International coordination

Supervisors have also engaged with large financial institutions to understand governance and control challenges. Among other topics, supervisors have been monitoring increased potential for internal and external fraud as a result of the work-from-home environment and assessing potential gaps in internal controls and internal audits created by the temporary movement of audit or control employees to assist with other activities.

### *Large financial institutions' supervisory priorities for 2020.*

For the remainder of 2020, supervisors have tailored safety and soundness supervisory activities to those that are most relevant to understanding and assessing a firm's financial and operational resilience. Specifically, supervisory work is focused on three areas: (i) examinations to support the timely issuance of supervisory ratings, (ii) examinations and monitoring of areas of heightened risk for the firms, and (iii) monitoring emerging risks related to the COVID event. Examination processes have been streamlined and adjusted to reflect the remote working environment.

## Community and Regional Banking Organizations

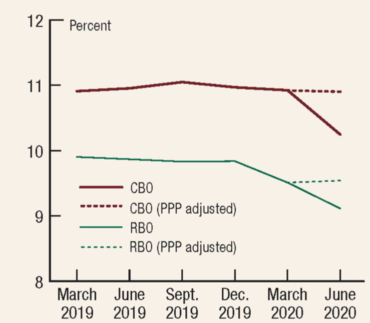
This section of the report discusses the supervisory approach for banking organizations with assets less than $100 billion, including CBOs, which have less than $10 billion in total assets, and RBOs, which have total assets between $10 billion and $100 billion.

### *Most CBOs and RBOs were in satisfactory condition prior to the COVID event.*

Most CBOs and RBOs entered 2020 in sound financial condition with improved risk management, including management of credit concentrations. At the end of 2019, over 95 percent of CBOs and RBOs had a supervisory rating of satisfactory or higher. More than 99 percent of CBO and RBO insured depository institutions were considered well capitalized, and more than 96 percent of CBOs and all RBOs were profitable in 2019.[19]

### *The majority of CBOs and RBOs remain in satisfactory condition, though the COVID event has impacted financial performance.*

**Figure 10. Tier 1 leverage ratio (CBOs and RBOs)**




Note: The PPP-adjusted leverage ratio was computed by subtracting PPP covered loans outstanding from the ratio's denominator, and then adding back to the denominator the quarterly average amount of PPP covered loans pledged to the PPPLF that were excluded from total assets for the leverage ratio.

Source: Call Report and FR Y-9C.

Community and regional banking organizations remain in generally satisfactory financial condition, though the COVID event has introduced significant financial uncertainty for the banking industry. The aggregate tier 1 leverage ratio remains relatively robust, at 10.2 percent for CBOs and nearly 9.1 percent for RBOs as of the second quarter of 2020 (figure 10), although capital ratios for these categories of banks have declined since the beginning of the COVID event. The decrease in the tier 1 leverage ratio is largely the result of strong PPP lending, which increased the assets used in the denominator of the leverage ratio. Adjusting for PPP loans, the aggregate tier 1 leverage ratio would be 10.9 percent for CBOs and 9.5 percent for RBOs as of June 30. Less than 1 percent of organizations in these two portfolios report capital levels that do not meet the "well-capitalized" designation.

In an effort to build capital resiliency, most CBOs and RBOs took steps to reduce capital distributions or build capital in the first and second quarters of 2020. CBO-insured depository institutions reduced their dividends in the second quarter to $2.7 billion from $4.5 billion in the fourth quarter of 2019. RBOs reduced their dividends over the same period to $2.0 billion

[19] The term "CBO and RBO insured depository institutions" refers to state member banks, nonmember banks, and national banks in the CBO and RBO portfolios.

### Box 7. Preliminary Third-Quarter Results for CBOs and RBOs

Based on recent examination findings, off-site monitoring activities, and preliminary regulatory reporting data, CBO and RBO state member banks have generally adapted to the changes in the economy and their operational environment. However, localized spikes in COVID-19 cases and related business closures have affected financial performance and operations of CBO and RBO state member banks.

From June 15, 2020, when examinations resumed, until October 1, 2020, the Federal Reserve examined 63 CBO and RBO state member banks. Based on preliminary examination results, Federal Reserve examiners did not uncover a greater number of supervisory issues compared with pre-COVID-event examinations. To date, none of these Federal Reserve-led examinations resulted in a downgrade from a satisfactory CAMELS composite rating to a less-than-satisfactory rating.

Most CBOs and RBOs expect positive net income for 2020, primarily because of income associated with PPP loans, mortgage origination fees, and securities gains. Liquidity conditions remain favorable, as CBOs and RBOs report generally stable or increasing liquidity levels and lower reliance on noncore funding. CBOs noted that a particular challenge is their inability to find attractive investment opportunities for excess funds. RBOs are using their excess liquidity to buy back bank debt, reduce brokered deposits, pay down commercial paper and borrowings, and grow their investment portfolios.

Although overall credit quality trends appear stable at this time, CBOs and RBOs remain vigilant in monitoring their loan portfolios because of the potential for future deterioration. Certain industries, including hospitality, restaurant, retail, and entertainment, continue to experience stress, though CBO and RBO bankers overall report only moderate and isolated credit quality concerns. Some banks have tightened underwriting standards and risk tolerances while economic conditions remain stressed.

Many CBOs and RBOs have maintained their dividend payments, and a number have either begun or are planning to resume share repurchase programs. Some institutions have indicated that economic conditions have generally stabilized or will be manageable, and their forecasts support these capital distributions. The Federal Reserve continues to encourage institutions to maintain capital resiliency while the COVID event is ongoing and uncertainty persists.

from $2.1 billion in the fourth quarter of 2019. To further preserve capital, most RBOs have suspended their share repurchase programs.

Profitability measures for CBOs and RBOs fell in the first half of 2020, after lockdowns and other measures were taken to control the spread of COVID-19 and as the COVID event began affecting businesses. Despite additional income from PPP loans, close to 4.6 percent of CBOs and 13.6 percent of RBOs were not profitable for the first half of 2020, as net interest income declined and provisions increased. A spike in first-quarter goodwill impairment losses also weighed on RBOs' profitability.

### Box 8. Interagency Coordination on Examinations

The uncertainty in today's economy and the operational challenges faced by supervised financial institutions highlight the importance of interagency efforts to coordinate safety and soundness supervisory activities. The Federal Reserve shares supervisory and regulatory responsibility for domestic member banks with individual state banking departments. In its role as the holding company supervisor, the Federal Reserve also interacts with all of the federal banking agencies. Therefore, the Federal Reserve's consolidated supervisory program requires strong, cooperative relationships with the primary federal and state agencies for insured depository institutions.

To limit potential duplication of supervisory activities and undue burden on supervised institutions, the Federal Reserve tailors its supervisory activities to an institution's legal entity and regulatory structure, as well as the risks associated with its activities, and relies, to the greatest extent possible, on the assessments of the primary supervisor for the insured depository institution.

The agencies have several well-established avenues to promote interagency coordination and collaboration, which have proven valuable in coordinating the agencies' response to the COVID event. Under the auspices of the Federal Financial Institution Examination Council (FFIEC), the agencies develop and issue uniform principles, standards, and report forms for the examination of financial institutions.

In response to the COVID event, the financial regulatory agencies are meeting more frequently to discuss the condition of supervised institutions and the results from their examinations and monitoring activities. These interagency discussions aid the agencies in developing and executing their supervisory plans and in adjusting supervisory policies. For instance, in June 2020, the agencies and the states worked together to develop COVID-related guidance to promote consistency and flexibility in the supervision and examination of financial institutions.[1] As noted in the guidance, safety and soundness examiners of all agencies were reminded that they should not criticize an institution's management that has managed risk appropriately by taking proper risk assessment and mitigation efforts in response to the stresses caused by the COVID event.

[1] Refer to SR Letter 20-15, "Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Institutions," https://www.federalreserve.gov/supervisionreg/srletters/sr2015.htm.

## *CBOs and RBOs made extraordinary efforts to work with their borrowers affected by the COVID event.*

CBOs and RBOs have made substantial efforts to support their borrowers with loan modifications. CBO- and RBO- insured depository institutions reported $367 billion, or roughly 10.5 percent of outstanding loans and leases, as modifications under section 4013 of the CARES Act. Loan modifications can include payment deferrals, interest-only payment periods, fee waivers, forbearance, and temporary suspensions from credit reporting.

Federal Reserve supervisors have found that while both CBOs and RBOs had expected to receive additional requests for loan modifications after those provided at the beginning of the COVID event (i.e., initial or first-wave modifications), new or additional requests for modifications (i.e., the second wave) have been fewer than the first wave. CBO modifications in the second wave have generally been limited to short-term targeted changes, typically an interest-only loan for a set period, and primarily provided to commercial borrowers in the hospitality and retail sectors.

While many RBOs saw a temporary increase in the second wave of loan modifications in July, the level of modification requests was still lower than the first wave. While institutions continue to work with their borrowers, they have formalized their underwriting process for those borrowers requesting additional modifications or are requiring a borrower to demonstrate a financial need and the ability to perform under the terms of the new modification request.

## *Several actions taken by the Federal Reserve addressed the unique challenges and operating conditions faced by CBOs and RBOs.*

To balance the responsibility to promote safety and soundness against institutions' operating challenges, the Federal Reserve has taken a number of actions:

- ***Extension of the filing deadline for the March financial regulatory reports***: The federal banking agencies provided institutions with relief on the filing deadline for their March 31, 2020, Call Reports, as long as an institution submitted the report within 30 days of the official filing date. Roughly 20 percent of Call Report filers took advantage of this additional time, with all respondents reporting within the additional time allowed. The Federal Reserve provided similar relief to holding companies with $5 billion or less in total assets for submitting the March 30, 2020, financial regulator reports (i.e., FR Y-9C and FR Y-11). Roughly 21 percent of eligible holding companies took advantage of this additional time.
- ***Temporary relief on the community bank leverage ratio (CBLR)***: The Federal Reserve and the other federal banking agencies adopted interim final rules to lower the CBLR from 9 percent to 8 percent beginning in the second quarter of 2020 and for the remainder of calendar year 2020. The ratio moves to 8.5 percent for calendar year 2021, and 9 percent thereafter. Roughly 40 percent of eligible banks have adopted the CBLR as of June 30, 2020, and 9.4 percent of CBLR adopters benefited from this relief, as their CBLR fell between 8 percent and 9 percent as of June 30, 2020.
- ***Deferral of certain appraisal regulatory requirements***: From April 17, 2020, through December 31, 2020, the federal banking agencies are deferring certain appraisals and evaluations for up to 120 days after closing of residential or commercial real estate loan transactions.

## *The supervisory approach has been adapted in response to the COVID event.*

As a result of the COVID event, the Federal Reserve has shifted the focus of CBO and RBO supervisory activities to assessing the overall safety and soundness of an institution as well as the effectiveness of an institution's risk management and responsiveness to changing economic and market conditions. Stresses caused by the COVID event can adversely affect an institution's financial condition and operational capabilities, even when institution management has appropriate governance and risk-management systems in place to identify, monitor, and control risk. Therefore, in assessing safety and soundness, examiners will consider the unique, evolving, and potentially long-term nature of the challenges confronting institutions and exercise appropriate flexibility in their supervisory response.[20]

[20] Refer to the Board press release on June 15, 2020, "Federal Reserve Statement on Supervisory Activities," https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200615a.htm.

### Box 9. Current CBO and RBO Supervisory Priorities

**Overall**

- Assessing capital and liquidity resiliency without impeding the flow of credit
- Evaluating risk-identification and management practices
- Prioritizing examiner resources on high-risk institutions

**Capital**

- Capital planning, projections, needs, and vulnerabilities
- Capital actions
- Earnings assessment

**Credit Risk**

- High-risk loan portfolios
- Credit concentrations
- Underwriting practices and asset growth
- Loan modifications
- Reserve practices and levels

**Operational Risk**

- Continuity of operations
- Information technology and cybersecurity

In mid-June, as operational conditions began to stabilize, the Federal Reserve resumed CBO and RBO examination activities and anticipates that examination activities, including full-scope examinations, will be conducted off-site until conditions improve to facilitate on-site examinations.[21] In scheduling CBO and RBO examinations, the Federal Reserve is considering unique safety and soundness concerns of each banking organization and their operational capacity for an examination.

One of the primary goals of the Federal Reserve's supervisory approach is to ensure the resilience of financial institutions while not impeding the flow of credit that is vital for economic recovery. Therefore, where possible, the Federal Reserve will streamline the supervisory review of lower risk, well-managed institutions in sound financial condition while focusing its supervisory attention on high-risk institutions as warranted by facts and circumstances.

Examiners will continue to assess CBOs and RBOs in accordance with existing policies and procedures and may provide feedback, or possibly downgrade an institution's supervisory rating, if conditions at the institution deteriorate. For the remainder of the year, the Federal Reserve's focus for CBO and RBO supervisory activities will be on evaluating a supervised institution's capital resiliency, liquidity resiliency, and effectiveness of an institution's risk management and responsiveness to changing economic and market conditions.

The Federal Reserve will continue its off-site monitoring activities of CBOs and RBOs and will maintain contact with bank management and other regulators. Such efforts provide the Federal Reserve with information on emerging risks and market trends along with the identification of industry trends and the concerns of bankers.

[21] From late-March to mid-June, the Federal Reserve paused most examination activities and shifted to off-site monitoring for CBOs and RBOs.

### Box 10. Partnership for Progress and Minority Depository Institutions

Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) of 1989, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), requires the Federal Reserve System to devote efforts toward preserving minority ownership of minority depository institutions (MDIs). The Federal Reserve supports these efforts and actively works with the FDIC and the OCC to leverage all perspectives and federal banking agency resources to implement the congressional mandates. The Federal Reserve recognizes that there is more to be done, especially as it relates to the decline in African American-owned banks. As such, the Federal Reserve remains strongly committed to providing support to MDIs.

MDIs are typically small community banks associated with Asian American, African American, Native American, or Hispanic American groups. In accordance with section 367 of the Dodd-Frank Act, the Board submits an annual report to the Congress detailing the actions taken to fulfill the FIRREA requirements.[1]

The Federal Reserve has primary supervisory responsibility for 14 state-member MDIs and provides direct technical assistance and outreach to these MDIs. However, the Federal Reserve views the congressional mandate to preserve and promote MDIs as more than simply supervising state-member MDIs. In this regard, the Federal Reserve actively works with the other federal banking agencies to coordinate interagency activities focused on supporting all MDIs.

The Federal Reserve established the System's Partnership for Progress (PFP) in 2008 to improve coordination of support to state-member MDIs.[2] The PFP program, a national outreach effort, helps MDIs confront unique business-model challenges, cultivate safe banking practices, and compete more effectively in the marketplace. Board staff and PFP-dedicated staff at each of the 12 Federal Reserve Banks oversee and coordinate the PFP activities.

In response to the COVID event, the Federal Reserve conducted several PFP outreach events on a number of COVID-event-related topics. For example, in May 2020, Governors Michelle Bowman and Lael Brainard held a video conference call with senior management at state-member MDIs to hear about their experiences and challenges in dealing with the ramifications of the COVID event on their operations, customers, and communities. Additionally, the Federal Reserve held two webinars with MDIs to provide technical assistance on the discount window and on the Paycheck Protection Program Liquidity Facility (PPPLF). The Federal Reserve will continue to explore avenues for assisting MDIs as they face the challenges posed by the COVID event.

1 Refer to the Board's public website for the most recent report to Congress, "Preserving Minority Depository Institutions," May 2020, at https://www.federalreserve.gov/publications/files/preserving-minority-depository-institutions-2020.pdf with the details on the Federal Reserve's MDI assistance, as well as a listing of state-member MDIs by state and the FIRREA section 308 provisions.

2 For more information on the PFP, see the Federal Reserve Board's website at https://fedpartnership.gov/.

# Appendix A: Data Appendix

## Definition of Data Sources

*The Supervision and Regulation Report* includes data on institutions supervised or not supervised by the Federal Reserve System. The report reflects data through October 16, 2020. This appendix details these sources.

### Earnings Release Data

The earnings release data shown in box 2 were collected by S&P Global Market Intelligence, and consist of the following 13 bank holding companies, which all reported third-quarter earnings by October 16: Ally Financial Inc.; Bank of America Corporation; The Bank of New York Mellon Corporation; Citigroup Inc.; Citizens Financial Group, Inc.; The Goldman Sachs Group, Inc.;, JPMorgan Chase & Co.; Morgan Stanley; The PNC Financial Services Group, Inc.; State Street Corporation; Truist Financial Corporation; U.S. Bancorp; and Wells Fargo & Company. Firm panels are fixed throughout all the series shown. Loan loss reserves data are not reported by The Goldman Sachs Group and Morgan Stanley in their earnings releases, so data for those two firms have been excluded from figure B. All firms shown in this data sample adopted CECL in the first quarter of 2020. For dates prior to March 31, 2020, loan loss reserves represent the allowance for loan and lease losses (ALLL). For dates including and after March 31 , 2020, loan loss reserves represent the allowance for credit losses (ACL) on loans and leases.

### FFIEC Call Reports

The FFIEC Consolidated Reports of Condition and Income, also known as the Call Report, is a periodic report that is required to be completed by every national bank, state member bank, insured nonmember bank, and savings association as of the last day of each calendar quarter. The details required to be reported depend on the size of the institution, the nature of the institution's activities, and whether or not it has foreign offices. Call Report data are a widely used source of timely and accurate financial data regarding a bank's financial condition and the results of its operations. The data collected from the Call Report are used to monitor the condition, performance, and risk profiles of the institutions as individuals and as an industry.

### FR Y-9C

The Consolidated Financial Statement for Holding Companies, also known as the FR Y-9C report, collects basic financial data from domestic BHCs, SLHCs, U.S. IHCs, and securities holding companies (SHCs). Respondent burden reduction initiatives led to the asset-sized threshold change from $500 million to $1 billion, and from $1 billion to $3 billion effective March 2015 and September 2018, respectively. In addition, BHCs, SLHCs, IHCs, and SHCs meeting certain criteria may be required to file this report, regardless of size. However, when such BHCs, SLHCs, IHCs, or SHCs own or control, or are owned or controlled by, other BHCs, SLHCs, IHCs, or SHCs, only top-tier holding companies must file this report for the consolidated holding company organization. The information contained in the report is as of the last day of each calendar quarter.

### H.8 – Assets and Liabilities of Commercial Banks in the United States

The H.8 release provides an estimated weekly aggregate balance sheet for all commercial banks in the United States. The H.8 release is primarily based on data that are reported weekly by a sample of approximately 875 domestically chartered banks and foreign-related institutions. Data for domestically chartered commercial banks and foreign-related institutions that do not report weekly are estimated at a weekly frequency based on quarterly Call Report data.

## Notes on Specific Data

### Allowance for Credit Losses Coverage Ratio

The ACL coverage ratio is the ratio of ACL over total loans.

Data for domestic LISCC firms include the following: Bank of America Corporation, The Bank of New York Mellon Corporation, Citigroup Inc., The Goldman Sachs Group, JPMorgan Chase & Co., Morgan Stanley, State Street Corporation, and Wells Fargo & Company.

Data for domestic LBO firms include the following: Ally Financial Inc.; American Express Company; Capital One Financial Corporation; Citizens Financial Group, Inc.; Discover Financial Services; Fifth Third Bancorp; Huntington Bancshares Incorporated; KeyCorp; M&T Bank Corporation; Northern Trust Corporation; The PNC Financial Services Group, Inc.; Regions Financial Corporation; Synchrony Financial; Truist Financial Corporation; and U.S. Bancorp. Data for consumer-focused LBO firms include the following: Ally Financial Inc., American Express Company, Capital One Financial Corporation, Discover Financial Services, and Synchrony Financial.

### Commercial Loans

As reported by firms in their public financial filings, commercial loans include commercial real estate loans, commercial lease financing, commercial construction loans, and commercial and industrial (C&I) loans.

### Commercial Real Estate Loans

The sum of construction, land development, and other land loans; loans secured by farmland; loans secured by multifamily residential properties; and loans secured by nonfarm nonresidential properties.

### Common Equity Tier 1

Common equity capital is currently evaluated using a common equity tier 1 (CET1) capital ratio, which was introduced into the regulatory capital framework with the implementation of Basel III. The CET1 capital ratio is defined as CET1 capital as a percent of risk-weighted assets. Advanced approaches institutions are required to report risk-weighted assets using an internal model-based approach and a standardized approach. An advanced approaches institution is subject to the lower of the ratios.

From 2006 through 2013, tier 1 common was used to measure common equity capital for all firms. In 2014, both tier 1 common capital (for non-advanced approaches firms) and CET1 capital (for advanced approaches firms) were used. From 2015 through 2019, CET1 capital was used for all firms. Starting in 2020, CET1 capital is used for all firms except those that have opted into the community bank leverage ratio (CBLR) framework.

### Community Bank Leverage Ratio Framework

The CBLR framework, which became effective January 1, 2020, allows qualifying CBOs to adopt a simple leverage ratio to measure capital adequacy. To qualify for the framework, a CBO must have less than $10 billion in total consolidated assets, have limited trading activity and off-balance-sheet exposure, meet the leverage ratio requirement, and not be part of an advanced approaches banking organization. The leverage ratio requirement for the CBLR framework was temporarily lowered to 8 percent beginning in the second quarter of 2020 through the remainder of calendar year 2020. The requirement will be set at 8.5 percent for calendar year 2021 and will return to its previous 9 percent level beginning January 1, 2022.

The leverage ratio requirement for the CBLR framework is defined as tier 1 capital as a percent of average total consolidated assets for the quarter as reported on Schedule RC-K on the Call Report or Schedule HC-K on Form FR Y-9C, as applicable. A CBLR bank organization with a ratio above the requirement will not be subject to other capital and leverage requirements.

### Consumer Loans

Consumer loans include credit cards, other revolving credit lines, automobile loans, and other consumer loans (includes single-payment and installment loans other than automobile loans, and all student loans).

### Credit Default Swap Spread

The five-year credit default swap (CDS) spread is the premium payment expressed as a proportion of the notional value of the debt that is being insured against default (typically $10 million in senior debt) in basis points. Data are based on daily polls of individual broker–dealers worldwide. Note that these broker quotes are typically not transaction prices. Data provided are for LISCC (domestic and foreign) firms only.

### Liquid Assets

Liquid assets are cash plus estimates of securities that qualify as high-quality liquid assets, as defined by the liquidity coverage ratio requirement. Because of data availability constraints, HQLA estimate amounts displayed in figure 5 are based on Y-9C data and not based on 2052a reporting data.

### Loan Modifications under Section 4013

Section 4013 of the CARES Act, enacted March 27, 2020, allows financial institutions to suspend the requirements to classify certain loan modifications as troubled debt restructurings. To be an eligible loan under section 4013, a loan modification must be: (1) related to COVID-19; (2) executed on a loan that was not more than 30 days past due as of December 31, 2019; and (3) executed between March 1, 2020, and the earlier of (a) 60 days after the date of termination of the National Emergency or (b) December 31, 2020 (referred to as the "applicable period").

## Loan Modifications Reporting in 10-Q SEC Filing

There is not a standard definition of “loan modifications” within the banking industry, and the SEC has not provided guidance on how firms should report these balances on their 10-Qs. Accordingly, while publicly disclosed loan modifications indicate the magnitude of these balances, they do not provide comparable data across firms.

## Market Leverage

The market leverage ratio—defined as the ratio of the firm’s market capitalization to the sum of market capitalization and the book value of liabilities—can be considered a market-based measure of firm capital (expressed in percentage points). Data provided are for LISCC (domestic and foreign) firms only.

## Nonperforming Loans

Nonperforming loans are those loans that are 90 days or more past due, plus loans in nonaccrual status.

## Provisions

For institutions that have adopted the Financial Accounting Standards Board’s Accounting Standards Update 2016-13, “Financial Instruments–Credit Losses (Topic 326): Measurement of Credit Loses on Financial Instruments” (ASU 2016-13), provisions represent the amount expensed as provisions for credit losses (or reversals of provisions) on loans and leases held for investment during the calendar year-to-date. Provision for credit losses (or reversals of provisions) on loans and leases held for investment represents the amount necessary to adjust the related allowances for credit losses at the quarter-end report date for management’s current estimate of expected credit losses on these assets.

For institutions that have not adopted ASU 2016-13, provisions represent the amount expensed as the provision for loan and losses during the calendar year-to-date. Provision for loan and lease losses represents the amount needed to make the allowance for loan and lease losses adequate to absorb estimated loan and lease losses, based upon management’s evaluation of the bank’s current loan and lease exposures.

## Top Holder

All data, unless otherwise noted, use top-holder data. This population comprises top-tier Call Report (NAT, NMB, and SMB) filers and top-tier Y-9C filers. In instances where a top-tier holding company does not file the Y-9C, we combine financial data of subsidiary banks to approximate the consolidated financial data of the holding company. Because of data limitations, all FBOs, SLHCs, and commercial bank subsidiaries of top-tier FBOs and SLHCs are excluded from the top-holder population.

# Appendix B: Abbreviations

| | |
|---|---|
| ACL | allowance for credit losses |
| ALLL | allowance for loan and lease losses |
| BHC | bank holding company |
| CAMELS | Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk |
| CARES Act | Coronavirus Aid, Relief, and Economic Security Act of 2020 |
| CBLR | community bank leverage ratio |
| CBO | community banking organization |
| CCAR | Comprehensive Capital Analysis and Review |
| CDS | credit default swap |
| CECL | current expected credit losses |
| CET1 | common equity tier 1 capital |
| CRE | commercial real estate |
| C&I | commercial and industrial |
| Dodd-Frank Act | Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 |
| FASB | Financial Accounting Standards Board |
| FBO | foreign banking organization |
| FDIC | Federal Deposit Insurance Corporation |
| FFIEC | Federal Financial Institutions Examination Council |
| FIRREA | Financial Institutions Reform, Recovery, and Enforcement Act of 1989 |
| G-SIB | global systemically important bank |
| HCR | horizontal capital review |
| HQLA | high-quality liquid assets |
| IHC | intermediate holding company |
| LBO | large banking organization |
| LFBO | large and foreign banking organization |
| LFI | large financial institutions |
| LIBOR | London interbank offered rate |
| LISCC | Large Institution Supervision Coordinating Committee |
| MDI | minority deposit institutions |
| NAT | national bank |
| NBA | nonbank assets |
| NMB | nonmember bank |

| | |
|---|---|
| NPL | nonperforming loan |
| OCC | Office of the Comptroller of the Currency |
| OFAC | Office of Foreign Assets Control |
| PFP | Partnership for Progress |
| PPP | Paycheck Protection Program |
| PPPLF | Paycheck Protection Program Liquidity Facility |
| RBO | regional banking organization |
| ROAA | return on average assets |
| ROE | return on equity |
| SBA | Small Business Administration |
| SEC | U.S. Securities and Exchange Commission |
| SHC | securities holding company |
| SLHC | savings and loan holding company |
| SMB | state member bank |
| wSTWF | weighted short-term wholesale funding |

www.federalreserve.gov
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Credit Union National Association
CUNA

Jim Nussle
President & CEO
Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE
Suite 300
Washington, D.C. 20003-3799

November 12, 2020

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
House of Representatives
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
House of Representatives
Washington, DC 20515

Dear Chairwoman Waters and Ranking Member McHenry,

On behalf of America's credit unions, I am writing to express our views ahead of the hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic." The Credit Union National Association (CUNA) represents America's credit unions and their more than 120 million members. We appreciate your consideration of our views.

The COVID-19 pandemic and ensuing economic crisis has impacted every aspect of society. Credit unions and their members have not been immune from the consequences, but credit unions have remained in a position to continue to serve their members through the crisis as a result of critical steps taken by Congress, the administration, and the National Credit Union Administration (NCUA).

**Credit Unions Remain in a Position to Help Consumers, but Looming Stress Suggests Congress and Regulators Need to Act Now to Head Off a Deeper Economic Crisis**

While the economy grew quickly in the third quarter, U.S. economic output remains roughly 3.5% lower than pre-crisis levels. For historical context, note that the peak-to-trough decline in economic output was 4.0% during the Great Recession.

The U.S. unemployment rate fell one full percentage point recently, ending October at 6.9% according to the Bureau of Labor Statistics (BLS). However, the true unemployment rate (which adjusts for misclassified unemployed workers on temporary layoff) is estimated by BLS to be 7.3%—more than double the 3.5% unemployment rate reported in February. Nearly four million consumers tell BLS they are permanently unemployed (up by 2.5 million since February).

The Census Bureau Household and Business Pulse Surveys reveals that significant additional economic assistance to consumers and small businesses is critically important:

- The most recent Census Bureau **Household Pulse Survey** shows that only 48% of those who reside in renter-occupied housing reported having "high confidence" that they would be able to pay "next month's rent." In addition, about two-thirds of those in owner-occupied housing have a mortgage payment obligation—and among those, only 70% reported "high confidence" in their ability to pay "next month's mortgage."
- The most recent Census Bureau **Small Business Pulse Survey** shows that nearly half—45%—of small business owners say they expect it will be at least six months before their business returns to normal operating levels. Overall, nearly 10% say they expect that their business will never return to "normal" pre-crisis levels.

Credit unions stand ready to continue to help:

- Collectively, the nation's 5,300 credit unions have ample liquidity, reflected in a 76.2% loan-to-savings ratio and surplus funds equal to 30% of assets (with 60% of those surplus funds in liquid assets).
- Asset quality is high with the credit union delinquency ratio sitting at 0.52% in December according to CUNA survey results. That puts delinquencies at their lowest level in the 30-year history we have been tracking this data.
- The system's capital ratio has stabilized at 10.5% [well above Prompt Corrective Action's (PCA) "well capitalized" level of 7%].

But, the significant looming stress reflected in the Census Bureau Household and Small Business Pulse Surveys suggests the NCUA and Congress should act now to head off a deeper and longer lasting crisis—and to ensure that credit unions maintain their ability to effectively intervene and help members navigate through the mounting near-term risks. Therefore, as Congress contemplates further COVID-recovery legislation and exercises its oversight responsibilities over the Federal financial regulators, it is critical that policy be examined and modified to ensure credit unions remain in a position to serve their members throughout and after this crisis.

**NCUA Should Take Further Steps to Ensure Credit Unions Remain in a Position to Serve Members During and After the Pandemic**

Throughout the pandemic, NCUA, under the leadership of Chairman Rodney Hood, has been responsive to the needs of credit unions. With only a few exceptions, the agency has moved swiftly to remove barriers keeping credit unions from serving their members as a result of the public health and economic crisis. However, as we have discussed with the agency in recent months, there is more that should be done. We have encouraged the NCUA to:

- refrain from any National Credit Union Share Insurance Fund (NCUSIF) premium assessments;
- temporarily exclude certain low-risk assets from the net worth ratio;
- permit capitalization of interest on consumer mortgage loans; and
- remove obstacles to consumers accessing the Payday Alternative Loans I Program.

*Refrain from Any National Credit Union Share Insurance Fund Premium Assessments*

As a result of an influx of deposits following a substantial government stimulus to consumers impacted by COVID-19, credit union deposits have swelled and the NCUSIF equity ratio temporarily declined. At its September Board meeting, NCUA reported that the NCUSIF equity ratio had dropped to 1.22% at mid-year from where it was last December at 1.35%. This is an understandable and temporary change reflecting the historically unprecedented deposit growth driven by members depositing COVID-19 economic impact payments.

NCUA announced the reasonable and appropriate step of having credit unions "top off" their deposit in the NCUSIF to account for these new deposits. This is expected to return the equity ratio to approximately 1.34%, which is above the statutory guideline for the normal operating level, 1.30%.

NCUA is prohibited from assessing premiums to fund the NCUSIF if the equity ratio is above 1.30%; and the agency is required to report to Congress a restoration plan if the equity ratio drops below 1.20%. In setting these parameters, Congress sent a clear message that a safe and sound equity ratio for the NCUSIF lays somewhere between 1.20% and 1.30%. Notwithstanding the unprecedented nature of the crisis, there is no reason to expect the equity ratio to drop below 1.20% in the absence of additional stimulus, in which case credit unions could be asked to top-off the fund again.

We are concerned that NCUA may take the unnecessary step of assessing credit unions a premium charge if the fund drops below 1.30% during this crisis. We urge the NCUA to forebear on any assessments, consistent with the forbearance toward distressed members the agency has urged credit unions to embrace. A temporary forbearance approach to the existing

NCUSIF equity ratio policy on levying insurance premiums is consistent with the stated approach of the Federal Deposit Insurance Corporation (FDIC).

*Temporarily Exclude Certain Low-Risk Assets from the Net Worth Ratio*

As noted above, deposits in credit unions have swelled during the crisis, largely as a result of government stimulus and changes in consumer spending and savings habits. Credit unions are increasingly investing these funds in zero- and low-risk assets, such as shorter-term Treasury securities. These deposits and resulting investments, however, have caused a decrease in the net worth ratio for many credit unions. Therefore, we have asked the NCUA to follow the lead of other Federal banking regulators and exclude such investments from the net worth ratio calculation.

The NCUA has broad authority in defining "total assets," which comprises the denominator of the net worth ratio. The NCUA Board acknowledged this authority in its interim final rule earlier this year that amended section 702.2(k) to allow credit unions to exclude from "total assets" loans pledged as collateral for Paycheck Protection Program (PPP) loans. Specifically, in that rule, the Board stated:

> The Board has broad authority to define the term "total assets." While 12 U.S.C. 1790d defines "net worth"—the numerator for determining the net worth ratio—it does not define the term "total assets," which comprises the denominator of the equation. However, the Board has elected to define the term in part 702. In addition to the Board's broad authority to define the term "total assets," the Board finds that given the unique and unprecedented nature of the COVID-19 pandemic, encouraging use of the PPP Facility by excluding pledged PPP loans from total assets would further the purpose of § 1790d. Pledged covered PPP loans present less risk and would potentially facilitate resolving the problems of credit unions at the least possible long-term cost to the NCUSIF compared to non-pledged covered PPP loans.[1]

CUNA supported that NCUA interim final rule, as we think it is important to encourage credit union participation in PPP lending. After further review, we believe the NCUA can extend this treatment to all PPP loans.

We believe it is equally important to amend the definition of "total assets" to exclude certain zero- and low-risk assets. Since we continue to find ourselves in a "unique and unprecedented" situation given the ongoing pandemic, it is imperative the agency provide additional flexibility regarding credit union capital. Thus, we have asked the NCUA to explore ways to reduce the denominator of the net worth ratio—including by excluding certain assets from the calculation—given that the savings growth is a result of the current environment as opposed to something credit unions are actively encouraging. Credit unions are not in the business of turning away members or their deposits, but this is a possible though unfortunate alternative that could stem declining net worth ratios.

[1] 85 Fed. Reg. 23,212, 23,214 n.18 (Apr. 27, 2020).

*Permit Capitalization of Interest on Consumer Mortgage Loans*

As stated in our letters to the NCUA on April 8,[2] June 29,[3] and September 16, 2020[4], we have asked the NCUA to permit credit unions to capitalize interest on consumer mortgage loans in connection with loan modifications made during the pandemic.

We appreciate the recent interagency guidance on loan modifications and troubled debt restructurings (TDRs)[5] as well as the provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act that provide for TDR accommodations. However, to further ease compliance requirements for loan modifications, the NCUA should reinterpret the capitalized interest section of Part 741, Appendix B to be consistent with the requirements of Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), as well as the other Federal financial regulators.

Currently, in order to make a TDR modification related to COVID-19 work for credit union members, the credit union must pursue one of the following options:

1. Collect interest current at the time of the modification: This causes additional hardship for members, especially members who may have become unemployed;
2. Forgive the interest: This harms the credit union, making it difficult to loan to other members, and creates potential tax ramifications for the members;
3. Defer the interest until the end of the loan term: This creates balloon payments for the members and could cause additional hardship; or
4. Adjust the amortization on the loan and bifurcate it to create a modified rate component and a zero-interest component: This is confusing for members and poses operational challenges for the credit union, as systems are not designed to easily incorporate such an adjustment.

It is clear another, more consumer-friendly option is needed. Thus, we urge the NCUA to permit credit unions to capitalize the interest on loans modified in connection with the pandemic. This is especially critical as it may take many months for many consumers to become financially healthy given the ongoing COVID-19 crisis.

*Remove Obstacles to Consumers Accessing the Payday Alternative Loans I Program*

We have also encouraged the NCUA to consider issuing an interim final rule amending section 701.21 to eliminate the requirement that a borrower "be a member of the credit union for at least one month"[6] before receiving a Payday Alternative Loan I (PAL I). This change would ensure credit unions have the flexibility necessary to meet the emergency credit needs of new credit union members.

In the current environment, economically distressed new members should not have to wait a month to be eligible for a PAL I loan. This requirement drives borrowers to more costly and potentially predatory lending sources, which produces the precise outcome policymakers sought to avoid through the PAL I program.

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[2] CUNA Letter to NCUA Chairman Rodney Hood (Apr. 8, 2020), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2020/Comment_Letters/Letter%20from%20CUNA%20CEO%20to%20NCUA%20Chairman%20Hood.pdf.

[3] CUNA Letter to NCUA Chairman Rodney Hood (June 29, 2020), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2020/Comment_Letters/Letter%20to%20NCUA%20Chairman%20Hood%20from%20Jim%20Nussle%206.29.2020.pdf.

[4] CUNA letter to NCUA Chairman Rodney Hood (Sept. 16, 2020), *available at* https://www.cuna.org/uploadedFiles/Letter%20from%20CUNA%20CEO%20Jim%20Nussle%20to%20NCUA%20Chairman%20Hood%209.16.2020.pdf.

[5] Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised) (Apr. 7, 2020), *available at* https://www.ncua.gov/files/press-releases-news/interagency-statement-tdr-policy-revised.pdf.

[6] 12 CFR 701.21(c)(7)(iii)(A)(6).

We have also asked the NCUA to provide additional guidance for credit unions assisting financially distressed borrowers with outstanding PALs. In some instances, members borrowed PALs at the maximum term permitted and now, as a result of a change in their financial situation, are seeking options to amend or extend their loans. We recommend the NCUA provide credit unions the flexibility to refinance these outstanding loans into other low-cost emergency credit products or to potentially extend the loan terms.

**Congress Should Take Legislative Action to Ensure Credit Unions Remain in a Position to Serve Their Members**

Like many others, we have been eagerly anticipating additional COVID recovery legislation. As we approach the end of the year, Congressional action is necessary if only to extend expiring provisions that have proved critical in the early stages of the crisis and remain necessary to keep credit unions in a position to serve their members. But, we hope Congress will enact more ambitious legislation than simply extending expiring provisions.

As we discuss below, we ask Congress to enact legislation that:

- *extends expiring CARES Act provision related to TDR;*
- *extends expiring CARES Act provision related to the Central Liquidity Facility (CLF);*
- *exempts Member Business Loans (MBL) during and for one year after the National Emergency;*
- *provides temporary flexibility to NCUA to offer forbearance from PCA requirements;*
- *Prevent Regulatory Penalties for PPP Lenders; and*
- *simplifies the PPP loan forgiveness process.*

*Extend Expiring CARES Act Provision Related to Troubled Debt Restructuring*

Section 4013 of the CARES Act states that if a loan was current either on December 31, 2019 or at the time of modification, COVID-related modifications to the loan are exempt from TDR treatment[7]. The exemption is set to expire at the end of 2020.

Section 4022 of the CARES Act states that Federally backed mortgage (Fannie, Freddie, VA, or FHA) borrowers may request loan forbearance for up to 12 months during the national emergency[8].

The issue credit unions face is that the TDR exemption provided under Section 4013 of the CARES Act lasts only until the end of 2020, but most forbearances will not end until 2021, at which time financial institutions will need to modify these loans. The unintentional misalignment of these two provisions of the CARES Act will result in variations in accounting treatment and operational complexities that make it more difficult for consumers to obtain loan modifications.

CUNA appreciates that the Committee is considering H.R. ____, the Protecting Consumers and Small Businesses through Forbearance Act which would extend the CARES Act TDR provision and forbearance provisions. An extension of the TDR provision is welcomed and much needed. However, while we support initiatives to aid distressed borrowers, CUNA is increasingly concerned about the impact a large volume of forbearances will have on the liquidity of lenders and servicers. The longer that lenders and servicers, especially non-bank servicing companies like credit union service organizations (CUSOs), are expected to deliver scheduled payments while the borrowers themselves are in deferment, the greater the likelihood that servicers will start to experience liquidity issues. Lenders and servicers cannot be expected to continue to cover the costs of forbearance indefinitely without some form of assistance themselves.

[7] 15 USC Ch. 116 §9051
[8] 15 USC Ch. 116 §9056

*Extend Expiring CARES Act Provision Related to the Central Liquidity Facility*

Section 4016 of the CARES Act provided a much-needed expansion of the NCUA's CLF, allowing corporate credit unions to act as agents for natural person credit unions and expanding the CLF's borrowing authority from 12 times the paid in capital to 16 times[9]. These changes make the CLF more accessible to credit unions and expand the amount of liquidity NCUA could provide credit unions. The expanded authority is set to expire at the end of the year.

As such, CUNA strongly supports H.R. 6789, the Access to Credit for Small Businesses Impacted by the COVID-19 Crisis Act of 2020 which would extend the CARES Act provision related to the CLF through 2021.

Given the unprecedented nature and the depth of this pandemic and the subsequent economic crisis, we urge Congress to expand the CLF's borrowing authority to 25 times the paid in capital, extend the expanded borrowing authority until December 31, 2021, and to make permanent the ability of corporate credit unions to act as agents for credit unions. The consequence of not having these provisions in place prior to this crisis is that NCUA had to engage in a membership campaign for the CLF, asking credit unions to contribute capital to the facility at the very time credit unions are most reluctant to give up capital. Congress should take steps to ensure the long-term viability of the CLF, so it is prepared to help credit unions in future crises.

*Exempt Member Business Loans During and for One Year After the National Emergency*

As the COVID-19 pandemic persists, small businesses across the country will continue to need capital and credit unions are able to pump billions into the economy—at no cost to the government. However, one obstacle stands in the way: the arbitrary credit union MBL cap which limits some credit union lending activity to 12.25% of assets.

Given the urgent financial needs of so many small businesses, now is the time to provide credit unions with additional flexibility to serve their business members by temporarily lifting the cap.

While credit union business lending has increased greatly since the Great Recession, many credit unions are now approaching the 12.25% of asset cap. We conservatively estimate that temporarily removing the MBL cap will provide over $5 billion in capital to small and informal business ventures, creating nearly 50,000 jobs over the course of the next year.[10]

Additional credit union lending will not impede bank lending activity. Small Business Administration (SBA) research shows that growth in credit unions' small business lending is apparent in many respects, but a majority of credit union business lending is for loans that banks will not originate. This means a majority of credit union lending does not replace lending that would otherwise be done by banks—it is lending that otherwise would not occur.[11] SBA research specifically shows that roughly 80% of credit union business loans are loans that banks would not make.

Small businesses and communities around the country are suffering and need access to relief quickly. Thus, CUNA strongly supports H.R. 6789, the Access to Credit for Small Businesses Impacted by the COVID-19 Crisis Act of 2020. This legislation would lift the credit union MBL cap for the duration of the COVID pandemic and one-year after the pandemic has been declared over for loans specific to COVID-19.

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[9] 12 U.S.C. 1795a

[10] CUNA Estimate Assumptions: 1. Grandfathered CUs, Non-Federally Insured and/or Low-Income designated do not increase lending; 2. Non-Commercial lenders lend in amount equal to 1% of assets on average under the new authority; 3. All other Commercial CUs lend in amount equal to 60% of their current use rate; 4. Estimates produced using assumptions 1-3 are further adjusted as follows: * CUs with net worth/assets <=6% are assumed to have no Commercial Loan growth. * CUs with net worth/assets between 6% and 7% remain at the current 12.25% cap. * CUs with Comm Lns/assets >= 10% are limited to a 30% increase in Commercial Loans in the 1st year. 5. First year increases: baseline estimate = 50% of new use rate; adjusted/conservative estimate = 40% of new use rate. Employment increase is based on Council of Economic Advisors 5/09 ARRA job creation estimates ($92,000 in spending creates 1 job / $109,633 in 2019 dollars).

[11] Wilcox, James A., The Increasing Importance of Credit Unions in Small Business Lending. Small Business Administration Office of Advocacy (2011).

*Provide Temporary Flexibility to NCUA to Offer Forbearance from Prompt Corrective Action Requirements*

Credit union capital requirements are different than bank requirements in several respects, including that only retained earnings count as Tier I capital for credit unions and thresholds for credit union capital levels are hardwired into statute.[12] These limitations restrict NCUA's ability to accommodate otherwise healthy credit unions impacted by natural disaster, pandemic and other crises.

While credit unions entered the crisis extremely well-capitalized, the impact of the ensuing economic crisis has and will put stress on capital and, given credit unions' limited ability to raise capital, the regulator could use additional tools. As Congress considers additional pandemic recovery legislation, we encourage it to include language that provides NCUA temporary flexibility to forbear from PCA credit unions impacted by the pandemic and which were otherwise healthy prior to the onset of the crisis.

*Simplify the Paycheck Protection Program Loan Forgiveness Process*

Credit unions were proud participants in the SBA's PPP. In fact, some credit unions were so eager to help their members through this program that they participated even though they had no previous relationship with the SBA. But the quick implementation and slow bureaucracy at the SBA led to significant and well documented problems for even the most experienced SBA lenders.

The PPP has played an important role in keeping small businesses and their employees afloat during the early stages of this crisis. Many small business owners are now applying for loan forgiveness and finding that process more cumbersome than the initial lending delays. Small businesses need to be focused on their businesses; lenders need to be focused on their borrowers. Congress should take steps to simplify the forgiveness process for small businesses and PPP lenders.

CUNA strongly supports H.R. 7777, introduced by Representatives Chrissy Houlahan and Fred Upton. This legislation would forgive PPP loans of less than $150,000 upon the borrower's completion of a simple, one-page forgiveness document. These loans account for 86% of all PPP recipients but less than 27% of PPP loan dollars. Expediting the loan forgiveness process for many of these hard-hit businesses will save more than $7 billion dollars and hours of paperwork.

*Preventing Regulatory Penalties for PPP Lenders*

We reiterate that credit unions were proud to help many Americans and American businesses throughout the COVID-19 pandemic with the SBA's PPP. Rapid deployment of funds through PPP was necessary to save jobs and businesses; however, the consequence of the stunted development phase was that the impact on financial institutions from these loans was not considered.

For many reasons, including a complex forgiveness process, PPP loans are remaining on financial institutions' balance sheets for longer than was originally anticipated and this is creating unintended consequences for these institutions that put so much effort into helping Americans. One important effect on PPP lending credit unions is that it can cause a credit union to cross an asset-based regulatory threshold. For credit unions, this occurs when net worth ratio falls below 7%, which causes a credit union to lose its status of being well capitalized. A less than well capitalized credit union becomes subject to the NCUA's rules for prompt corrective action, which require credit unions to comply with many additional onerous regulations designed to increase their capital.

PPP loans should not impact a credit union's balance sheet as loans are intended to be short term and fully guaranteed by the SBA. That said, CUNA supports H.R. 8675, the Preventing Regulatory Penalties for PPP Lenders Act and

[12] 12 U.S.C. § 1790d(c).

H.R. ___ that would temporarily exclude PPP loans from certain asset calculations which will remedy this unintended consequence to credit unions that originated PPP loans.

**Diversity Equity and Inclusion Must be Intentional**

CUNA and its members are committed to ensuring that diversity, equity, and inclusion continue to play a meaningful role throughout every aspect of the financial services sector. We recognize that credit unions and all in the financial services sector, including our regulators, must be intentional about increasing diversity and inclusion at leadership, board, and staff levels to continue to reach and better serve an increasingly diverse population. That said, CUNA supports the Diversity in Financial Regulatory Advisory Committees Act, which would require consideration of at least one gender and racially or ethnically diverse individual when filling advisory committee vacancies at certain financial regulatory agencies, including NCUA.

**Conclusion**
On behalf of America's credit unions and their more than 120 million members, thank you for holding this important hearing and considering our views.

Sincerely,

Jim Nussle
President & CEO

INDEPENDENT COMMUNITY BANKERS *of* AMERICA®



November 9, 2020

The Honorable Mitch McConnell
Majority Leader
United States Senate
Washington, D.C. 20510

The Honorable Charles Schumer
Democratic Leader
United States Senate
Washington, D.C. 20510

The Honorable Nancy Pelosi
Speaker
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Kevin McCarthy
Republican Leader
U.S. House of Representatives
Washington, D.C. 20515

Dear Majority Leader McConnell, Democratic Leader Schumer, Speaker Pelosi, and Republican Leader McCarthy:

On behalf of community banks across the country, with more than 52,000 locations, I write to urge you to enact pandemic relief legislation before the close of the 116th Congress. This morning we received encouraging news on the prospects for a highly effective vaccine that could be distributed in the coming months. The end of a tragic and costly health and economic crisis may be in sight. But millions of small businesses will not be able to survive into the post-pandemic economy without help from Congress. We urge you to extend hope to these businesses and the Americans who depend on them for their livelihood. Timely action is needed. An effective pandemic relief package must contain the following provisions.

**Simplified Forgiveness Needed for Small Paycheck Protection Program Loans**

For all loans with an original balance of $150,000 or less, Congress should create a presumption of compliance based on the borrower's certification that the funds were used in accordance with the terms of the program.

The Paycheck Protection Small Business Forgiveness Act (S. 4117), introduced by Senators Kevin Cramer and Robert Menendez, would create a presumption of compliance for these loans. A House companion bill, H.R. 7777, was introduced by Reps. Chrissy Houlahan and Fred Upton. Protections against fraud and misrepresentation would still apply. These bills have broad bipartisan and bicameral support and should be part of any package advanced in the remaining months of this Congress.



WASHINGTON, DC
1615 L Street NW
Suite 900
Washington, DC 20036

SAUK CENTRE, MN
518 Lincoln Road
P.O. Box 267
Sauk Centre, MN 56378

866-843-4222
www.icba.org

**Restore Full Forgiveness for All Economic Injury Disaster Loan Advances (EIDL)**

Pandemic relief must include the EIDL Forgiveness Act (H.R. 8361), sponsored by Reps. Joe Neguse and John Curtis. EIDL Advance forgiveness is also included in the Heroes Small Business Relief Act, sponsored by Senator Ben Cardin, and the updated version of the HEROES Act, passed by the House on October 1, 2020. We do not believe it was the intent of Congress to effectively trap one million vulnerable small businesses with unexpected debt.

**Exclude PPP Loans from Regulatory Asset Thresholds**

Pandemic relief should include legislation to direct the federal banking regulators to exclude PPP loans from bank and bank holding company asset threshold calculations. Many community banks will incur costly and burdensome new regulatory requirements as an unintended consequence of their PPP lending. These banks should not be punished for providing a lifeline to the small businesses and non-profit organizations that sustain their communities and local jobs. Legislation sponsored by Mike Lee in the Senate (S. 4875) and Barry Loudermilk and David Scott in the House (H.R. 8675) would adjust asset threshold calculations to exclude PPP loans.

**Bank Capital and Accounting Relief**

- Extend Troubled Debt Restructuring (TDR) provisions of the CARES Act through December 31, 2021.
- Make 8% Community Bank Leverage Ratio (CBLR) permanent for institutions of $10 billion or less in assets.

Thank you for your consideration. It is critically important that Congress pass pandemic relief legislation in the short time that remains in the 116th Congress. We look forward to continuing to work with you to sustain the American economy as this crisis evolves.

Sincerely,

/s/

Rebeca Romero Rainey
President and CEO

CC: Senate Banking Committee Chairman Mike Crapo
Senate Banking Committee Ranking Member Sherrod Brown
House Financial Services Committee Chairwoman Maxine Waters
House Financial Services Committee Ranking Member Patrick McHenry



WASHINGTON, DC
1615 L Street NW
Suite 900
Washington, DC 20036

SAUK CENTRE, MN
518 Lincoln Road
P.O. Box 267
Sauk Centre, MN 56378

866-843-4222
www.icba.org

3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org

NAFCU
National Association of Federally-Insured Credit Unions

November 10, 2020

| | |
|---|---|
| The Honorable Maxine Waters | The Honorable Patrick McHenry |
| Chairwoman | Ranking Member |
| Committee on Financial Services | Committee on Financial Services |
| United States House of Representatives | United States House of Representatives |
| Washington, DC 20515 | Washington, DC 20515 |

**Re: Thursday's Hearing, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic"**

Dear Chairwoman Waters and Ranking Member McHenry:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts ahead of Thursday's hearing, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic." NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 122 million consumers with personal and small business financial service products. NAFCU and our members welcome the Committee's oversight of financial regulators and ongoing efforts to address the current pandemic. Ahead of this hearing, we would like to share our thoughts on a few important issues for credit unions relating to the pandemic for both the lame-duck Congress and long-term.

NAFCU has highlighted six main priorities that we would like the National Credit Union Administration (NCUA) to address over the next few months that can provide relief to credit unions as they serve their members during the pandemic:

1. *Expanding Virtual Meetings.* The NCUA should provide guidance permitting virtual annual meetings and all board meetings to be solely virtual in 2021 to help protect the health and safety of credit union volunteers.
2. *Managing Unexpected Share Growth.* Considering the unique circumstances, the NCUA should provide more specialized and flexible parameters for meeting certain capital and supervisory requirements.
3. *Additional Investment Opportunities.* The NCUA should expand investment opportunities available to credit unions, including in the areas of asset-backed securities and corporate bonds.
4. *Capitalizing Interest on Loan Modifications.* Establishing parity with bank regulators' treatment of loan modifications will ease burdens on both credit unions and consumers.
5. *Adopting Broader Capital Reform.* Broader capital reform is critical during this time, including finalization of the subordinated debt rule, further guidance on asset securitization, and further delay of the risk-based capital rule.

The Honorable Maxine Waters, The Honorable Patrick McHenry
November 10, 2020
Page 2 of 3

6. *Finalizing an Efficient and Measured Budget.* In finalizing the 2021 budget, efficiency, transparency, and prudent management of credit union dollars is essential to the safety and soundness of the industry.

NAFCU outlined these requests in more detail in a letter to the NCUA earlier this week.

We would specifically highlight in this letter the importance of flexibility for credit unions in managing unexpected share growth due to the pandemic. Many credit unions have seen their balance sheet grow due to reductions in consumer spending and various relief programs during the pandemic. This growth may prove to be temporary, and we believe it is important that regulators grant flexibility from new requirements or burdens that may change once the pandemic is over. It is with this in mind that we request the NCUA extend the relief for Prompt Corrective Action (PCA) beyond December 31, 2020. Additionally, we also believe that the NCUA should consider issuing a rule to temporarily revise its definition of total assets, as permitted under the *Federal Credit Union Act* (FCU Act), as a means of alleviating regulatory stresses caused by excess share growth. We urge you to ask NCUA Chairman Rodney Hood about these measures. We also would support legislative efforts to address the share growth issue should they come before your Committee, such as H.R.8675, the *Preventing Regulatory Penalties for PPP Lenders Act*.

Tied closely to share growth at credit unions is the need for additional investment opportunities for credit unions. NAFCU has urged the NCUA to do what it can to expand opportunities in this area given the influx of deposits and need of credit unions. However, should additional credit union investment opportunities require a change to the FCU Act, we ask that you support such a legislative fix to help credit unions better assist their members and their communities.

NAFCU is also supportive of several of the bills associated with this hearing, including H.R.6789, the *Access to Credit for Small Businesses Impacted by the COVID-19 Crisis Act,* which provides important temporary relief from the credit union member business lending (MBL) cap so that credit unions can provide needed capital to main street small businesses as they struggle to recover. This legislation also provides an important extension of the CARES Act provision dealing with the Central Liquidity Facility (CLF) for credit unions. We urge advancement of this important legislation. We also support extending troubled debt restructuring (TDR) relief, such as that found in the CARES Act. Additionally, we support efforts to provide relief for Community Development Financial Institutions (CDFIs) and to promote diversity, equity, and inclusion in financial services.

NAFCU also supports the many legislative efforts that have been proposed to address the Current Expected Credit Loss (CECL) standard and the detrimental effect it will have, particularly on credit unions with their unique capital framework. Earlier this year, Chairman Hood wrote to the Financial Accounting Standards Board (FASB) echoing NAFCU's calls for a credit union exemption to the CECL standard. We hope the Committee will proceed with legislative measures to provide relief from CECL and encourage the NCUA to take steps to minimize its impact on credit unions.

Lastly, NAFCU would like to express our opposition to the NCUA's request on third-party vendor examination authority. NAFCU and our member credit unions believe that cybersecurity is an important issue, including the security of vendors that credit unions do business with; accordingly, we have created our own task force of our members to examine this issue. However, NAFCU is opposed to granting additional authority to the NCUA to examine third parties at this time. NAFCU believes in a strong NCUA, but that the NCUA should stay focused on regulating credit unions. There are other tools already in place for the agency to get access to information about vendors. We believe the agency's time and resources are better focused on reducing regulatory burden by coordinating efforts among the financial regulators.

In conclusion, we thank you for your leadership and ongoing oversight of prudential regulators. NAFCU is pleased to see the Committee examining ways to continue regular oversight particularly during these uncertain times. We urge you to also continue to consider additional measures that will help credit unions to better serve their members. We appreciate the opportunity to share our input and look forward to continuing to work with the Committee to balance minimizing regulatory burden with enhancing the safety and soundness of the credit union system. Should you have any questions or require any additional information, please contact me or Janelle Relfe, NAFCU's Associate Director of Legislative Affairs, at 703-842-2836.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the House Financial Services Committee

November 10, 2020

The Honorable Randal Quarles
Vice Chairman of Supervision
Board of Governors of the Federal Reserve System

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation

Mr. Brian Brooks
Acting Comptroller of the Currency
Office of the Comptroller of the Currency

The Honorable Rodney Hood
Chairman
National Credit Union Administration

The Honorable Kathy Kraninger
Director
Consumer Financial Protection Bureau

Re: **Request for Additional Guidance under the Interagency Statements on Troubled Debt Restructurings**

Ladies and Gentlemen:

As the end of 2020 approaches, the undersigned organizations urge the agencies above (Agencies) to provide guidance that COVID-19-related loan modifications with terms totaling more than six months (e.g., up to 18 months) do not automatically result in troubled debt restructurings (TDR) under the *Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised)* and *Joint Statement on Additional Loan Accommodates Related to COVID-19* (Interagency Statements). We also urge the Agencies to reinforce that financial institutions may use their reasonable judgment when assessing credit risk during the unique circumstances of the pandemic.

**Extend TDR Relief to Allow for an Incremental Approach**

Early on in the pandemic, the Agencies took proactive and decisive action to allow financial institutions to deliver meaningful relief to customers by providing guidance that short-term loan modifications with terms of up to sixth months would not automatically result in a TDR. Congress also took action to provide TDR relief in section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which does not limit the term of a loan modification for modifications made by December 31, 2020. To date, these actions have been particularly effective in allowing lenders to offer prudent relief to commercial real estate borrowers who have been acutely affected by the pandemic and whose properties are reasonably expected to return to viability post the pandemic.

Unfortunately for financial institutions and borrowers, many of the modifications granted under the Interagency Statement and section 4013 of the CARES Act are reaching the end of their six-month terms at that same time that the CARES Act protections are set to expire on December 31, 2020. This confluence of events creates challenges for any financial institution that determines that it is most prudent to continue employing a deliberate, incremental approach when its manages requests for further extensions of those existing modifications, where the combined terms of all modifications will be greater than six months.

- If an institution elects to continue to employ an incremental approach, any incremental loan modification that occurs after year-end 2020 will result in an automatic TDR.
- Alternatively, the financial institution can avoid TDR treatment by making a loan modification before the end of 2020 with a term as long as could possibly be necessary, forgoing its incremental approach.

To foster and support financial institutions' continued use of an incremental approach to managing loan modifications during the pandemic, we urge the Agencies to provide guidance that a loan modification with a term greater than six months (*e.g.,* up to 18 months combined) will not automatically result in a TDR under the Interagency Statements.

**Credit Assessments**

We recognize TDR relief does not also relieve a financial institution from responsibility for managing the credit risk of the loan. For example, even if a loan modification does not result in a TDR under the CARES Act or under the Interagency Statements, financial institutions will need to critically assess and monitor the credit risk of the loan as modified and under current circumstances. As a result, it will be critical going forward for the Agencies to continue to recognize the need for financial institutions to have flexibility to use their reasonable, market-based judgment when assessing credit risk under the current idiosyncratic circumstances of the pandemic. Business-as-usual approaches may not be effective or appropriate. For example, in some cases, commercial properties will have a viable pathway to stabilization, but recognizing that fact in a risk assessment may require an adjustment to pre-pandemic approaches. We encourage the Agencies to reaffirm that financial institutions have flexibility to use reasonable and prudent judgment to give borrowers and lenders more time to see properties and loans through this pandemic.

* * *

Again, we appreciate the action by the Agencies to proactively issue the Interagency Statements early in the National Emergency to provide financial institutions with the flexibility they needed to do the right thing, even if that meant not doing business as usual. We now urge the Agencies to provide financial institutions with the additional flexibility they need to continue to do the right thing, by providing guidance that modifications up to 18 months do not automatically result in TDRs and reinforcing financial institutions' flexibility to use their reasonable and expert judgment when assessing credit risk. Because this issue is urgent, we request that the Agencies issue such a clarification and reaffirmation as soon as possible.

Sincerely,

**Mortgage Bankers Association**
**American Hotel & Lodging Association**
**American Resort Development Association**
**Asian American Hotel Owners Association**
**CRE Finance Council**
**International Council of Shopping Centers**
**Latino Hotel Association**
**Nareit**
**The Real Estate Roundtable**

cc: Conference of State Bank Supervisors
American Council of State Savings Supervisors
National Association of State Credit Union Supervisors

DOCUMENT 1



# FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility

The following is intended to address Frequently Asked Questions (FAQs) about the Primary Market Corporate Credit Facility (PMCCF) and the Secondary Market Corporate Credit Facility (SMCCF) (together, the CCFs). Please check this website for new FAQs and more information.

Effective August 14, 2020

## PURPOSE AND DESIGN

**Why is the Federal Reserve establishing the PMCCF and the SMCCF?**
Recent events have significantly and suddenly impacted financial markets. The spread of COVID-19 has harmed communities and substantially disrupted economic activity in many countries, including the United States. The disruption has affected many different sectors of the financial system. In general, the availability of credit has contracted for corporations and other issuers of debt while, at the same time, the disruptions to economic activity have heightened the need for companies to obtain financing. These disruptions have been felt by even highly rated companies that need liquidity in order to pay off maturing debt and sustain themselves until economic conditions normalize.

The PMCCF provides a funding backstop for corporate debt to Eligible Issuers so that they are better able to maintain business operations and capacity during the period of dislocation related to COVID-19. The SMCCF supports market liquidity for corporate debt by purchasing individual corporate bonds of Eligible Issuers and exchange-traded funds (ETFs) in the secondary market.

**How are the PMCCF and SMCCF structured and what can they invest in?**
Pursuant to section 13(3) of the Federal Reserve Act, and with prior approval of the Secretary of the Treasury, the Board of Governors of the Federal Reserve System (Board) authorized the Federal Reserve Bank of New York (New York Fed) to establish the PMCCF and SMCCF. The New York Fed is lending to a special purpose vehicle (SPV) through which the CCFs operate. The financing provided by the New York Fed to the SPV is with full recourse to the SPV and secured by all the assets of the SPV.

The PMCCF provides companies access to credit by (i) purchasing qualifying bonds as the sole investor in a bond issuance, or (ii) purchasing portions of syndicated loans or bonds at issuance. The SMCCF may purchase in the secondary market (i) corporate bonds issued by investment-grade U.S. companies; (ii) corporate bonds issued by companies that were investment-grade rated as of March 22, 2020, and that remain rated at least BB-/Ba3 at the time of purchase; (iii) U.S.-listed ETFs whose investment objective is to provide broad exposure to the market for U.S. investment-grade corporate bonds; and (iv) U.S.-listed ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds.

**In what way is the U.S. Department of the Treasury supporting the CCFs?**
The Department of the Treasury, using funding from the Coronavirus Aid, Relief, and Economic Security Act

(CARES Act), has committed to make $75 billion in equity investment in the SPV for both of the CCFs. The initial allocation of the equity will be $50 billion toward the PMCCF and $25 billion toward the SMCCF.

**Is there a limit to the size of the SPV?**
The combined size of the CCFs will be up to $750 billion. The PMCCF will leverage Treasury's equity at 10 to 1 when acquiring corporate bonds or syndicated loans from Eligible Issuers that are investment grade at the time of purchase. The PMCCF will leverage Treasury's equity at 7 to 1 when acquiring corporate bonds or syndicated loans from Eligible Issuers that are rated below investment grade at the time of purchase.

The SMCCF will leverage Treasury's equity at 10 to 1 when acquiring corporate bonds of issuers that are investment grade at the time of purchase and when acquiring ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds. The SMCCF will leverage Treasury's equity at 7 to 1 when acquiring corporate bonds of issuers that are rated below investment grade at the time of purchase and in a range between 3 to 1 and 7 to 1, depending on risk, when acquiring any other type of eligible asset.

**Over what time period will the SPV operate?**
The CCFs will cease purchasing eligible corporate bonds, eligible syndicated loans, and eligible ETFs no later than December 31, 2020, unless the CCFs are extended by the Board of Governors of the Federal Reserve System and the Department of the Treasury. The New York Fed will continue to fund the CCFs after such date until the CCF's holdings either mature or are sold.

**Will information about lending under the CCFs be made known to the public?**
The Federal Reserve will publicly disclose information regarding the CCFs during the operation of the facilities, including information regarding participants, transaction amounts, costs, revenues and other fees.

Balance sheet items related to the SPV and CCFs will be reported weekly, on an aggregated basis, on the H.4.1 statistical release titled "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks," published by the Board of Governors of the Federal Reserve System.

In addition, the Federal Reserve will disclose to Congress information pursuant to section 13(3) of the Federal Reserve Act, the Board's Regulation A, and the CARES Act.

**Do revised term sheets replace previously published term sheets?**
Yes.

**How will the SMCCF initially conduct bond purchases?**
The SMCCF will initially purchase corporate bonds to create a corporate bond portfolio that tracks a broad market index developed for the SMCCF (Broad Market Index). The index will be recalculated at least every 4-5 weeks, and the list of bonds that are eligible for purchase will be refreshed more frequently to add or remove those bonds that newly meet or no longer meet the eligibility requirements.

The SMCCF may purchase individual corporate bonds using other methodologies in the future.

**How is the Broad Market Index constructed?**
The Broad Market Index is intended generally to track the composition of the broad, diversified universe of secondary market bonds that meet the criteria specified in the Term Sheet for Eligible Broad Market Index Bonds, subject to generally applicable issuer-level caps specified by the Term Sheet. Each time the index is refreshed, the SMCCF will identify all of the secondary market bonds that meet the Term Sheet criteria for Eligible Broad Market Index Bonds. Next, limits relevant to each issuer, calculated on a par basis as the lesser of the cap of 10% of an issuer's maximum historical outstanding bonds and 1.5% of the maximum combined CCF facility size, will be applied to generate the index contribution for each eligible issuer. These contributions will then be aggregated, and the proportion of each issuer's bonds in the aggregate form their weight in the index.

Individual issuer weights will form the basis of sector weights, with each issuer mapped to one of twelve sectors (basic industry, capital goods, communications, consumer cyclical, consumer non-cyclical, energy, insurance, non-bank/insurance financials, real estate investment trusts, technology, transportation, and utilities). Purchases will track as closely as possible the sector weights in the index, and any overage or shortfall during a month will be addressed in the following month's purchases. The composition of the index may vary from month to month as newly issued eligible corporate bonds are added and bonds which become ineligible are removed. If sufficient bonds become eligible or ineligible for the index prior to a recalculation date to cause any sector weight to deviate from the existing index weight by more than 50 basis points, the index will be recalculated as soon as practicable.

**Which bonds will be included in the Broad Market Index?**
The Broad Market Index will consist of Eligible Broad Market Index Bonds. Consistent with the Term Sheet, these are corporate bonds that, at the time of index calculation, (i) are issued by an issuer that is created or organized in the United States or under the laws of the United States; (ii) are issued by an issuer that meets the rating requirements for Eligible Individual Corporate Bonds; (iii) are issued by an issuer that is not an insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company, as such terms are defined in the Dodd-Frank Act; and (iv) have a remaining maturity of 5 years or less.

The amount of any single issuer's bonds included in the Broad Market Index is also subject to limits as described in the Term Sheet and herein. For example, if from March 22, 2019, through March 22, 2020, Company X had $150 billion in outstanding bonds (all of which had 3 years to maturity) and Company Y had $80 billion in outstanding bonds (all of which had 3 years to maturity):

- Company X would have $11.25 billion of bonds in the Broad Market Index (given that any issuer is capped at 1.5 percent of the $750 billion combined potential size of the SMCCF and the PMCCF), and
- Company Y would have $8 billion of bonds in the Broad Market Index (given that any issuer is capped at 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019 and March 22, 2020).

**Do issuers need to provide certifications in connection with the SMCCF's Eligible Broad Market Index Bond purchases?**
No. The issuers of bonds acquired in the SMCCF's Eligible Broad Market Index Bond purchases do not need to provide certifications.

**Do issuers need to provide certifications in connection with the SMCCF's Eligible Individual Corporate Bond purchases?**
At any time that the SMCCF purchases Eligible Individual Corporate Bonds, the issuers of such bonds must meet all of the Eligible Issuer requirements described in the Term Sheet and as clarified herein. The requirements and processes for issuer certification will be provided before the SMCCF begins any Eligible Individual Corporate Bond purchases.

**Will the PMCCF or the SMCCF purchase bonds of issuers that are majority-owned or controlled by a foreign government?**
No.

**How are bonds issued by wholly-owned subsidiaries of Eligible Issuers treated in the SMCCF Broad Market Index?**
If the subsidiary is independently rated, the rating of the subsidiary determines the bond's eligibility. If the subsidiary is not independently rated, the ratings of the parent company and the bond jointly determine the bond's eligibility.

**Will the Broad Market Index include bonds of issuers incorporated in the United States but not domiciled in the United States?**
No. An issuer must be domiciled and incorporated in the United States to be included in the Broad Market Index.

**How will the SMCCF's Eligible Broad Market Index Bond purchases track the index?**
Over the course of each 4-5 week period, the SMCCF will purchase Eligible Broad Market Index Bonds to bring its portfolio holdings in line with the Broad Market Index. It will not be possible for the SMCCF's purchases to exactly replicate the index at all times. As a result, the primary focus of the SMCCF's Eligible Broad Market Index Bond purchases will be to track as closely as possible the sectoral weights of the index. Eligible Broad Market Index Bond purchases will also generally track the ratings and maturity profile of the index. However, the maturity profile of the purchases is expected to be several months longer than the index's maturity profile, as the SMCCF will likely underweight purchases of bonds maturing within six months of the date of purchase.

**If an issuer files for bankruptcy protection or drops below the minimum rating requirement, will the SMCCF continue purchasing bonds of that issuer?**
No. The SMCCF will not purchase bonds of issuers that have filed for bankruptcy protection or bonds of issuers that no longer meet the facility's minimum rating or other requirements. Such bonds also will be removed from the Broad Market Index and excluded from consideration in the calculation and tracking of the index when it is next recalculated.

**Will the SMCCF sell its holdings of corporate bonds in order to track the Broad Market Index?**
No. Bonds held by the SMCCF will not be sold for the purpose of tracking the index. However, the SMCCF may occasionally sell bonds to resolve trading or settlement issues in connection with transactions into which it has entered.

**How does the SMCCF decide how many bonds or ETFs to buy each day?**
The pace of purchases is based on a percentage of average daily volumes in the respective markets. The percentage to be purchased each day is based upon an array of measures of corporate bond market functioning, the rate of change of such measures, and other indicators. Measures of corporate bond market functioning include, but are not limited to, transaction cost estimates, bid-ask spreads, credit curve shape, spread levels and volatility, trading volumes, and dealer inventories. With respect to ETF purchases, ETF-specific measures such as premium or discount to net asset value ("NAV") and creation/redemption volumes are considered. With respect to bond purchases, the results of SMCCF and PMCCF operations, demand in the PMCCF, PMCCF share of new issuance, and pricing and amounts of new issuance are considered.

If the measures used to size daily purchases indicate sustained improvement in market functioning, to levels at or near those prevailing prior to the COVID-19 dislocation, SMCCF purchases are expected to slow notably and, in some cases, could pause entirely. If those measures subsequently indicate a deterioration in market functioning, however, SMCCF purchases would be expected to increase.

**When did the CCFs become operational?**
The SMCCF began purchasing eligible ETFs on May 12 and corporate bonds on June 16. The PMCCF began operating on June 29.

**How will the Federal Reserve include minority-, women-, and veteran-owned business entities in supporting the CCFs?**
The Federal Reserve is committed to the fair inclusion and utilization of minority-, women-, and veteran-owned (MWV) business entities as it responds to the economic effects of the pandemic. In supporting the Corporate Credit Facilities (CCFs), the SMCCF will consider expanding the pool of entities it will transact with as Eligible Sellers to include a wider range of entities, including MWV-owned business entities. In addition, MWV-owned business entities may participate as underwriters in the PMCCF, and issuers are strongly encouraged to utilize them. Finally, as short-term vendor relationships are revisited in the coming months, the Federal Reserve will look to include a broader set of firms, including MWV-owned business entities, in the various roles supporting the CCFs.

**Which investment managers are supporting the CCFs?**
Initially, BlackRock Financial Markets Advisory will be the investment manager, acting at the sole direction of the New York Fed on behalf of the facilities. Once the exigent need to commence operations of the facilities has passed, the investment manager role will be subject to a competitive bidding process.

**Will the investment manager apply its own internal investment guidelines when implementing the PMCCF and SMCCF?**
No. The Federal Reserve will provide investment guidelines to the investment manager to implement the central objective of the CCFs, that is, to support the availability of credit to large employers in the U.S. The investment manager will act as a fiduciary to the SPV in performing investment management services and be required to follow the Federal Reserve's investment guidelines. The investment management agreements are available on the New York Fed's SMCCF website and PMCCF website.

**Who are the points of contact at the Federal Reserve for the PMCCF and SMCCF?**
You can direct your questions to pmccf@ny.frb.org or smccf@ny.frb.org.

**How may I receive updates regarding changes to PMCCF and SMCCF documents?**
Sign up to receive PMCCF email alerts and SMCCF email alerts. You also may check the Federal Reserve websites for periodic updates to the PMCCF and SMCCF.

## ELIGIBLE ISSUERS AND SELLERS

**What is an Eligible Issuer under the PMCCF and under the SMCCF individual corporate bond purchase program?**

To qualify as an Eligible Issuer, the issuer must satisfy certain conditions:

First, the issuer must be a business that is created or organized in the United States or under the laws of the United States with significant operations in and a majority of its employees based in the United States.

Second, the issuer must have been rated at least BBB-/Baa3 as of March 22, 2020, by a major nationally recognized statistical rating organization (NRSRO). If rated by multiple major NRSROs, the issuer must have been rated at least BBB-/Baa3 by two or more NRSROs (one of which must be from Fitch Ratings, Inc., Moody's Investors Service, Inc., or S&P Global Ratings) as of March 22, 2020. An issuer that was rated at least BBB-/Baa3 as of March 22, 2020, but was subsequently downgraded, must be rated at least BB-/Ba3 as of the date on which the PMCCF or SMCCF makes a purchase. If rated by multiple major NRSROs, such an issuer must be rated at least BB-/Ba3 by two or more NRSROs (one of which must be from Fitch Ratings, Inc., Moody's Investors Service, Inc., or S&P Global Ratings) at the time the PMCCF or SMCCF makes a purchase. In every case, issuer ratings are subject to review by the Federal Reserve.

Third, the issuer is not an insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company, as such terms are defined in the Dodd-Frank Act.

Fourth, the issuer must not have received specific support pursuant to the CARES Act or any subsequent federal legislation.

Fifth, the issuer must satisfy the conflicts-of-interest requirements of section 4019 of the CARES Act.

**Are parent companies of Industrial Loan Companies considered to be depository institution holding companies?**
No.

**Will the Federal Reserve require a certification of eligibility from Eligible Issuers under the PMCCF?**
Eligible Issuers under the PMCCF are required to certify compliance with the eligibility criteria. The certification forms are available on the New York Fed's PMCCF website.

**What forms need to be completed in order to borrow under the PMCCF?**
In order to borrow under the PMCCF, Eligible Issuers must complete several forms, including CARES Act certifications, a Regulation A certification, and the PMCCF's program-specific authorization form. Additional information may be required and collected throughout the process of borrowing under the PMCCF. All of the forms are available here.

**CARES Act certifications (Advance Issuer Certification Packet):**
Eligible Issuers are strongly encouraged to complete the CARES Act certifications well in advance of expected issuance under the PMCCF in order to expedite the Facility's participation. If the CARES Act certifications are completed prior to trade date, they must be returned via email to the New York Fed (CCFForms@ny.frb.org). If the CARES Act certifications are submitted on trade date, they must be returned via email directly to the investment manager (pmccf@blackrock.com).

**Regulation A certification (Trade Date Issuer Certification Packet):**
In order to be an Eligible Issuer for the PMCCF, a company must certify compliance with the eligibility criteria set forth in Section 13(3) of the Federal Reserve Act and Regulation A of the Board of Governors of the Federal

Reserve System ("Regulation A"). The Board's Regulation A certification form must be completed on trade date and sent via email directly to the investment manager (pmccf@blackrock.com).

**PMCCF program-specific authorization forms:**
Eligible Issuers and the Underwriter or Initial Purchaser named as Billing & Delivery (B&D) agent in the transaction must also complete the PMCCF's program-specific authorization form. When the PMCCF is participating in transactions alongside other investors, these forms will be completed on trade date. When the PMCCF is the sole investor in a bond issuance, these forms should be completed in advance of trade date. These forms must be sent via email directly to the investment manager (pmccf@blackrock.com). The forms are available at the following links:
Co-Investor Issuer Authorization Form
Co-Investor Underwriter Authorization
Sole Investor Issuer Authorization Form
Sole Investor Underwriter Authorization

Eligible Issuers will need to complete the Regulation A certification, CARES Act certifications, and the PMCCF program-specific authorization form for each instance of borrowing under the PMCCF.

**From which NRSROs will ratings be accepted?**
The ratings criteria for the CCFs refer to ratings provided by major NRSROs. Major NRSROs include Fitch Ratings, Inc., Moody's Investors Service, Inc., and S&P Global Ratings. Major NRSROs also include DBRS, Inc., Kroll Bond Rating Agency, Inc., and A.M. Best Rating Services, Inc. (A.M. Best Rating Services, Inc. only with respect to insurance companies) to the extent that the issuer also has a qualifying rating from Fitch Ratings, Inc., Moody's Investors Service, Inc., or S&P Global Ratings. In all cases, ratings from an NRSRO will not be accepted if the NRSRO did not rate the Eligible Issuer as of March 22, 2020.

**Must Eligible Issuers pay the facility fee each time they issue to the PMCCF?**
Yes. The facility fee will be applied to each issuance to, or borrowing from, the PMCCF.

**What types of entities are eligible to sell securities to the SMCCF?**
Each institution from which the SMCCF purchases securities must be a business that is created or organized in the United States or under the laws of the United States with significant U.S. operations and a majority of U.S.-based employees. The institution also must satisfy the conflicts-of-interest requirements of section 4019 of the CARES Act. These institutions are collectively referred to as Eligible Sellers.

To expedite the implementation of the SMCCF, the SMCCF began by transacting with Primary Dealers, or affiliates thereof, that meet the Eligible Seller criteria. The Federal Reserve Bank of New York may add additional counterparties as Eligible Sellers under the SMCCF, subject to adequate due diligence, compliance, and other reviews. A full description of eligibility and program requirements for firms interested in participating as Eligible Sellers in the SMCCF can be found in the Expression of Interest (EOI) materials and Frequently Asked Questions (FAQs) for the Section 13(3) facility counterparty and agent expansion.

**What does "specific support pursuant to the CARES Act or subsequent federal legislation" mean with regard to issuers?**
To participate in the PMCCF as an issuer or in the SMCCF as an issuer of eligible individual corporate bonds, the issuer must certify that it has not received specific support pursuant to the CARES Act. This issuer certification is not required in connection with the SMCCF broad market index purchase program. "Specific support" in this context means specific support pursuant to section 4003(b)(1)-(3) of the Coronavirus Economic Stabilization Act of 2020 (Subtitle A of Title IV of the CARES Act). Section 4003(b)(1)-(3) authorizes the Department of the Treasury to make loans, loan guarantees, and other investments in support of certain eligible businesses. An issuer will not be eligible for the PMCCF or SMCCF if it has received a loan, loan guarantee, or other investment from the Treasury Department under section 4003(b)(1)-(3).

**If an issuer takes advantage of tax credits in the CARES Act, will that make the issuer ineligible for the CCFs?**
No. An issuer may utilize tax credits or tax relief in the CARES Act and still participate in the CCFs.

**Are issuers able to borrow under both the PMCCF and a Main Street Facility?**
No. Issuers may not participate in the PMCCF and a Main Street Lending Facility.

**How is "significant operations in and a majority of its employees based in the United States" evaluated for an Eligible Issuer or Eligible Seller in the CCFs?**
An Eligible Issuer in the PMCCF, an Eligible Issuer in the SMCCF's purchases of Eligible Individual Corporate Bonds, and an Eligible Seller in the SMCCF (each, an Eligible Entity) must have "significant operations in and a majority of its employees based in the United States."

If an Eligible Entity is not a subsidiary whose sole purpose is to issue debt, the Eligible Entity, on a consolidated basis (i.e., together with its consolidated subsidiaries), must have significant operations in and a majority of its employees based in the United States. Under this test, in evaluating the Eligible Entity, the Federal Reserve would not consider any parent company or sister affiliate.

If the Eligible Entity is a subsidiary whose sole purpose is to issue debt, any corporate affiliate of the Eligible Entity to which 95 percent or more of the proceeds from the syndicated loan or corporate bond purchase are transferred for use in its operations (the "primary corporate beneficiary") must have significant operations in and a majority of its employees based in the United States on a consolidated basis. If there is no primary corporate beneficiary, it is required that corporate affiliates that, in each case, have significant operations in and a majority of their employees based in the United States on a consolidated basis must receive, in the aggregate, 95 percent or more of the proceeds from the syndicated loan or corporate bond purchase.

**What does "significant operations in the United States" mean?**
A variety of issuers of different sizes in a range of industries are potentially eligible to participate in the PMCCF and SMCCF, provided that they have "significant operations" in the United States. While not an exhaustive definition, the following are examples of what would constitute significant operations in the United States for an Eligible Issuer or Eligible Seller seeking to participate in these facilities:

An Eligible Issuer or Eligible Seller with greater than 50% of its consolidated assets in, annual consolidated net income generated in, annual consolidated net operating revenues generated in, or annual consolidated operating expenses (excluding interest expense and any other expenses associated with debt service) generated in the United States as reflected in its most recent audited financial statements.

**Can a U.S. company that is a subsidiary of a foreign company qualify as an Eligible Issuer?**
An Eligible Issuer must be created or organized in the United States or under the laws of the United States. An Eligible Issuer may be a subsidiary of a foreign company, provided that (i) the Eligible Issuer itself is created or organized in the United States or under the laws of the United States, and (ii) the Eligible Issuer on a consolidated basis has significant operations in and a majority of its employees based in the United States. An Eligible Issuer in the PMCCF that is a subsidiary of a foreign company must use the proceeds derived from participation in the PMCCF only for the benefit of the Eligible Issuer, its consolidated U.S. subsidiaries, and other affiliates of the Eligible Issuer that are U.S. businesses, and not for the benefit of its foreign affiliates.

**Is a U.S. subsidiary or U.S. branch or agency of a foreign bank considered to be created or organized in the United States or under the laws of the Unites States for purposes of qualifying as an Eligible Seller under the SMCCF?**
Yes, a U.S. subsidiary or U.S. branch or agency of a foreign bank would be considered to be created or organized in the United States or under the laws of the Unites States and would thereby satisfy this criterion but must also satisfy all of the other relevant criteria specified in the term sheet to qualify as an Eligible Seller under the SMCCF.

**Are the limits contained in the CCF term sheets (e.g., PMCCF 130% cap on issuance, purchase limit of 1.5% of maximum combined CCF facility size, SMCCF 10% cap on maximum outstanding amount) calculated at the issuer or consolidated top-tier parent level?**
The limits are calculated at the consolidated top-tier parent level.

**May a company identify or form a new entity to serve as an issuer to the PMCCF?**
Yes. Such an issuer generally may rely on the ratings history of any U.S. affiliate that is guaranteeing the issuance

and would be limited in its issuances by the 130% cap calculated based on the historical issuances of its consolidated top-tier parent.

**How will issuers demonstrate that they are in compliance with CARES Act requirements in the PMCCF and SMCCF?**
Before participating in the PMCCF as an issuer, the issuer must certify compliance with the eligibility criteria set forth in the CARES Act. The CARES Act certification includes the U.S. business requirement and the conflicts of interest requirement under section 4019 of the CARES Act. The CARES Act certifications, along with all other forms required for participating in the PMCCF, are available on the New York Fed's PMCCF website. SMCCF requirements and processes for issuer certification will be provided before the SMCCF begins eligible individual corporate bond purchases. Issuer certifications are not required in connection with the SMCCF broad market index purchase program.

**How will sellers demonstrate that they are eligible to participate in the SMCCF?**
The certification requirements for sellers are publicly available on the New York Fed's website. Upon determination that all eligibility criteria are satisfactorily met, the facility may begin purchasing instruments from such Eligible Sellers.

**Will non-profit organizations be eligible issuers under the PMCCF and SMCCF?**
Yes. If a non-profit organization meets the eligibility criteria, it will be considered an eligible issuer under the CCFs.

**Will business development companies be Eligible Issuers under the PMCCF?**
Yes. If a business development company meets the eligibility criteria, it will be considered an Eligible Issuer under the PMCCF. With respect to these companies, (i) the manager of the business development company must be a U.S. business with significant operations in and a majority of its employees based in the United States, and must make all applicable certifications and (ii) the business development company's portfolio companies must, in the aggregate, have significant operations in and a majority of their employees based in the United States. Business development companies must have procedures in place to ensure that the proceeds of a PMCCF issuance are not transmitted to an insolvent portfolio company.

**Can an eligible issuer participate in both the PMCCF at the same time its bonds have been or are being purchased by the SMCCF?**
Yes, but the collective purchases by the PMCCF and SMCCF of an eligible issuer's debt are subject to the per-issuer limits described in the respective Term Sheets.

**Do Eligible Issuers include issuers which were not investment grade on March 22, 2020, but were subsequently upgraded by a major NRSRO to investment grade?**
No. If the issuer did not satisfy the required rating criteria as of March 22, 2020, but was subsequently upgraded to investment grade, it will not be eligible for the Facilities.

**When the SMCCF and PMCCF term sheets mention NRSRO ratings, does this only include published and maintained ratings, or does this also include point-in-time ratings feedback that is not published or maintained on an ongoing basis, such as Moody's Rating Assessment Service?**
The facilities will consider only published ratings.

**How can mutual funds, pension funds, and other entities sell corporate bonds and ETFs to the SMCCF?**
An investor may be able to sell its Eligible Assets to the SMCCF via any Eligible Seller with whom such investors may have a business relationship.

**How should an Eligible Seller handle information related to trading activity by the SMCCF?**
The SMCCF seeks to foster transparency and fair access to information about its activities. It does so by publishing the components of the Broad Market Index it intends to track and then announcing on a monthly basis the specific bonds and ETFs it has actually purchased. Accordingly, the SMCCF expects that Eligible Sellers will not use or share nonpublic information that they receive while acting as an Eligible Seller for any purpose other than executing and completing transactions with the SMCCF and in furtherance of the Eligible Seller's risk management

and internal control requirements. The SMCCF believes this expectation is broadly consistent with good market practice for the handling of institutional counterparty trading information.

## ELIGIBLE ASSETS

**What are Eligible Assets that will be purchased by the PMCCF?**
The PMCCF may purchase eligible corporate bonds as the sole investor in a bond issuance. Eligible corporate bonds must, at the time of purchase, be issued by an Eligible Issuer and have a maturity of 4 years or less.

The PMCCF also may purchase portions of syndicated loans or bonds of Eligible Issuers at issuance. Eligible syndicated loans or bonds must, at the time of purchase, be issued by an Eligible Issuer and have a maturity of 4 years or less. The PMCCF may purchase no more than 25 percent of any syndicated loan or bond issuance. To start, the PMCCF will focus on purchasing bonds at issuance.

**Does the definition of Eligible Assets in the PMCCF include investment-grade senior secured bonds issued by a non-investment-grade issuer?**
No. In order to be an Eligible Asset under the PMCCF, a bond must be issued by an Eligible Issuer that is rated at least investment grade as of March 22, 2020, and at least BB-/Ba3 at the time of purchase.

**What types of assets will be purchased by the SMCCF?**
The SMCCF may purchase individual corporate bonds that are issued by an Eligible Issuer; have a remaining maturity of 5 years or less as of the date of purchase; and are sold to the SMCCF by an Eligible Seller (Eligible Individual Corporate Bonds).

The SMCCF also may purchase from Eligible Sellers individual corporate bonds to create a corporate bond portfolio that tracks a broad market index (Eligible Broad Market Index Bonds). Eligible Broad Market Index Bonds are corporate bonds that, at the time of purchase, (i) are issued by an issuer that is created or organized in the United States or under the laws of the United States; (ii) are issued by an issuer that meets the rating requirements for Eligible Individual Corporate Bonds; (iii) are issued by an issuer that is not an insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company, as such terms are defined in the Dodd-Frank Act; and (iv) have a remaining maturity of 5 years or less.

The SMCCF also may purchase from Eligible Sellers U.S.-listed ETFs whose investment objective is to provide broad exposure to the market for U.S. corporate bonds. The preponderance of ETF holdings will be of ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, and the remainder will be in ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds. In some cases, the holdings of ETFs may include underlying bonds that have a remaining maturity longer than 5 years at the time of purchase, or include underlying bonds that would otherwise be ineligible for purchase by the SMCCF.

**Can the SMCCF purchases include corporate bonds issued after March 22, 2020?**
Yes.

**Will the SMCCF purchase non-USD denominated corporate bond issues?**
No.

**Will floating-rate debt that references LIBOR be eligible for purchase?**
If the PMCCF is the sole participant in an offering, the Facility only will purchase fixed-rate bonds. The PMCCF generally will only purchase fixed-rate debt when participating in a syndicated issuance. To the extent that the PMCCF is approached to participate in a syndication of floating-rate debt, the PMCCF generally will expect any debt priced off LIBOR to include adequate fallback language. The SMCCF intends to purchase a range of bonds, including floating-rate debt that is priced at a spread to LIBOR.

**Which ETFs will the SMCCF buy?**
The preponderance of ETF holdings will be of ETFs whose primary investment objective is exposure to U.S. investment-grade corporate bonds, and the remainder will be of ETFs whose primary investment objective is exposure to U.S. high-yield corporate bonds. In some cases, the holdings of ETFs may include underlying bonds

that have a remaining maturity longer than 5 years at the time of purchase, or include underlying bonds that would otherwise be ineligible for purchase by the SMCCF.

**What are the general criteria that are considered in determining which ETFs the SMCCF will purchase?**
The SMCCF considers several factors in determining which ETFs will be eligible for purchase. Those considerations include: the composition of investment-grade and non-investment-grade rated debt, the management style, the amount of debt held in depository institutions, the amount of debt held in non-U.S. companies, the average tenor of underlying debt, the total assets under management, the average daily trading volume, and leverage, if any.

**Will the SMCCF or PMCCF purchase subordinated bonds?**
The SMCCF and PMCCF do not expect to purchase corporate bonds that are widely considered to be subordinated to other corporate bonds of the issuer.

**Will the SMCCF or PMCCF purchase bonds issued by U.S. branches, agencies, or subsidiaries of non-U.S. banking organizations?**
No. Not purchasing bonds from these entities is consistent with the treatment of U.S. depository institution holding companies, depository institutions, and subsidiaries of depository institution holding companies.

**Will the facilities be able to purchase corporate bonds issued pursuant to SEC Rule 144A?**
The SMCCF and PMCCF may purchase privately placed corporate bonds pursuant to SEC Rule 144A.

## OTHER TERMS

**Are Eligible Issuers able to use the PMCCF to refinance existing bonds or issue new bonds?**
Eligible Issuers may approach the PMCCF to refinance existing bonds and issue new bonds, subject to conditions and limitations. An Eligible Issuer may refinance outstanding debt up to three months ahead of the maturity date of such outstanding debt. Eligible Issuers also may approach the PMCCF at any time to issue additional debt, provided that the Eligible Issuer's rating is reaffirmed at BB-/Ba3 or above by each major NRSRO that has rated the Eligible Issuer and the Eligible Issuer's reaffirmed rating accounts for the additional debt.

**Are there limits to using the PMCCF to refinance existing bonds or issue new bonds?**
The maximum amount of outstanding bonds and loans of an Eligible Issuer that borrows from the PMCCF may not exceed 130 percent of the Eligible Issuer's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020. Additionally, there is a single-name concentration limitation on an Eligible Issuer's use of the PMCCF and SMCCF. The maximum amount of instruments that the PMCCF and the SMCCF combined will purchase with respect to any Eligible Issuer is capped at 1.5 percent of the $750 billion combined potential size of the PMCCF and the SMCCF.

**How is the level of outstanding bonds and loans defined for purposes of PMCCF issuer limits?**
The amount of outstanding bonds and loans includes current and non-current portions of corporate bonds and loans, including drawn portions of "term loans," drawn portions of long-term "revolving facilities" (i.e., maturity greater than one year), and long-term bonds (whether USD denominated or otherwise). Any operating leases, non-recourse debt, commercial paper, and other short-term liabilities are not included. Information on debt should be consistent with the issuer's audited financial reports maintained during the March 22, 2019 to March 22, 2020 period, including the value of non-USD denominated debt. Issuers that are public companies may not use a higher amount of outstanding bonds and loans than is reflected in public filings.

**May maturing loans be refinanced by corporate bonds under the PMCCF?**
Yes. Maturing loans from the period of three months ahead of the maturity date may be refinanced and replaced with corporate bonds under the PMCCF. All borrowings are subject to per-issuer limits.

**How should the issuer convert non-U.S. dollar ("USD") denominated debt to USD denominated debt in the determination of maximum outstanding debt?**
The PMCCF will only purchase bonds and loans denominated in USD. For the purposes of calculating maximum bonds and loans outstanding, the value of non-USD denominated debt should be consistent with the issuer's financial statements for periods ending between March 22, 2019, and March 22, 2020.

**When the PMCCF is participating in transactions alongside other investors, is there a required minimum amount or percentage of the total deal?**
The PMCCF does not have a minimum amount or percentage of the total deal. While not prohibited, Eligible Issuers are not expected to use the PMCCF to borrow very small amounts or small percentages of the total deal.

**When the PMCCF purchases eligible corporate bonds as the sole investor, is there a required minimum deal size?**
There is no required minimum issuance amount.

**When the PMCCF is participating in a transaction alongside other investors, does the 25% maximum participation apply to a single tranche or a total transaction, which may consist of multiple tranches?**
The PMCCF maximum participation limit is applied on an individual tranche basis, assuming all eligibility criteria are met.

**Are there single-issuer purchase limits across the PMCCF and SMCCF?**
The maximum amount of bonds (including Broad Market Index Bonds) or syndicated loans that the CCFs will purchase with respect to any single issuer is capped at 1.5 percent of the combined potential size of the CCFs. If all assets purchased by the CCFs were investment grade, the combined potential size of the CCFs would be $750 billion. Measurement of the 1.5 percent cap for any issuer will be determined at the time of purchase of an issuer's bond or syndicated loan.

**How is an issuer's PMCCF borrowing capacity determined?**
The maximum amount of debt that an Eligible Issuer may have outstanding after borrowing from the PMCCF is 130 percent of the Eligible Issuer's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020 (the "130% issuer cap"). The full amount of debt issued in a transaction involving the PMCCF counts against the 130% issuer cap. Where an Eligible Issuer that is at or below the 130% issuer cap approaches the PMCCF with a proposal to refinance existing debt in a transaction that would settle up to three months ahead of the maturity date of such outstanding debt, such outstanding debt with a maturity of three months or less that is being refinanced using the proceeds of the transaction will no longer count against the 130% issuer cap, as described in greater detail in related questions below. Issuers may also approach the PMCCF with a proposal to refinance debt in a transaction that would settle more than three months ahead of the maturity date of the debt being refinanced, but because the debt to be refinanced has a remaining maturity of more than three months, under PMCCF program terms such debt will fully count against the 130% issuer cap until maturity, alongside the new debt incurred in the PMCCF transaction.

For the scenarios below, suppose issuer ABC's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020 (the "historical maximum") was **$2.0 billion.**
The 130% issuer cap would be **$2.6 billion** (i.e., 130% of the historical maximum of $2.0 billion).

*Scenario 1 – Issuer proposes to issue additional debt with no refinancing. Outstanding debt on transaction date is lower than the 130% issuer cap.*

- Outstanding debt on transaction date, without giving effect to the transaction: $1.5 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $0
- Maximum total borrowing permitted from the PMCCF for additional debt: $1.1 billion

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion).

*Scenario 2 – Issuer proposes to refinance existing debt with no additional borrowing. Outstanding debt on transaction date is higher than the 130% issuer cap.*

- Outstanding debt on transaction date, without giving effect to the transaction: $2.61 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $2.0 billion
- Maximum total borrowing permitted from the PMCCF: $0

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, outstanding debt of $2.61 billion on transaction date exceeds the 130% issuer cap. No borrowing (additional debt or refinancing) is permitted under the PMCCF.

*Scenario 3 – Issuer proposes to refinance existing debt with no additional borrowing. Outstanding debt on transaction date is at or lower than the 130% issuer cap.*

- Outstanding debt on transaction date, without giving effect to the transaction: $2.6 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $2.0 billion
- Maximum total borrowing permitted from the PMCCF: $2.0 billion

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, outstanding debt of $2.6 billion on transaction date does not exceed the 130% issuer cap. The amount being refinanced that matures within three months temporarily does not count towards the cap once the new debt has been issued (see relevant questions below).

**Does debt that is maturing within three months and is being refinanced count towards the 130% issuer cap during the period before it is repaid and the new indebtedness is outstanding?**
No. If an issuer borrows under the PMCCF to repay debt maturing within three months, the debt being refinanced does not count towards the Eligible Issuer's 130% issuer cap from the date of issuance under the PMCCF until the maturity date of the debt being refinanced. However, this exclusion from the 130% issuer cap will not prevent the cap from being exceeded (and the proposed transaction therefore being impermissible) if the issuer's maximum debt outstanding exceeds the cap (i) prior to giving effect to the transaction or (ii) after giving pro forma effect to the transaction and the assumed repayment of such maturing debt.

For the scenarios below, suppose issuer ABC's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020 (the "historical maximum") was **$2.0 billion.**
The 130% issuer cap would be **$2.6 billion** (i.e., 130% of the historical maximum of $2.0 billion).

*Scenario – Issuer proposes to issue additional debt and refinance existing debt.*

- Outstanding debt on transaction date: $2.0 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $1.0 billion
- Maximum total borrowing permitted from the PMCCF: $1.6 billion

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, the $1.6 billion in borrowing would consist of $1.0 billion of outstanding debt being refinanced and $600 million in additional debt. From the date of issuance under the PMCCF until the repayment of the $1.0 billion in outstanding debt being refinanced, the $1.0 billion in debt being refinanced does not count toward the 130% issuer cap.

**When the PMCCF is participating in transactions along with other investors, how does the total transaction size impact an issuer's borrowing capacity?**
When the PMCCF is participating in a transaction alongside other investors, the Facility may purchase no more than 25% of the par amount of the issue. However, the total amount of the transaction (i.e., 100%) counts toward the 130% issuer cap.

For the scenarios below, suppose issuer ABC's maximum outstanding bonds and loans on any day between March 22, 2019, and March 22, 2020 (the "historical maximum") was **$2.0 billion.**
The 130% issuer cap would be **$2.6 billion** (i.e., 130% of the historical maximum of $2.0 billion).

*Scenario 1 - Issuer proposes to issue additional debt with no refinancing.*

- Outstanding debt on transaction date: $2.0 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $0
- Total proposed transaction amount: $800 million (of which up to $200 million would be allocated to the PMCCF)
- Maximum total borrowing permitted from the PMCCF in the proposed transaction: $0

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, the total amount of the proposed transaction ($800 million) would result in outstanding debt of $2.8 billion, which exceeds the 130% issuer cap. The fact that the PMCCF would only be taking a portion of the proposed $800 million transaction is not relevant to the analysis.

*Scenario 2 - Issuer proposes to issue additional debt and refinance existing debt.*

- Outstanding debt on transaction date: $2.0 billion
- Outstanding debt maturing within three months that ABC intends to refinance: $200 million
- Total proposed transaction amount: $800 million (of which up to $200 million would be allocated to the PMCCF)
- Maximum total borrowing permitted from the PMCCF: $200 million (i.e., 25% of $800 million)

Reason: ABC can borrow under the PMCCF until its total pro-forma debt reaches its 130% issuer cap (i.e., $2.6 billion). In this scenario, borrowing includes $200 million specified for refinancing debt maturing within three months and $600 million specified as additional debt. From the date of issuance under the PMCCF until the maturity date of the $200 million in outstanding debt being refinanced, the $200 million in outstanding debt being refinanced does not count toward the 130% issuer cap. In this scenario, if the proposed total transaction size were greater than $800 million, the issuer would not be able to borrow under the PMCCF at all, as is illustrated in scenario 1.

**How are the requirements for ratings reaffirmation determined?**

Unless the Eligible Issuer is borrowing under the PMCCF solely for the purpose of refinancing debt maturing within three months, its ratings must be reaffirmed at BB-/Ba3 or above by each major NRSRO with a rating of the issuer (the "additional debt ratings reaffirmation requirement"). When the PMCCF is participating in transactions alongside other investors, the total amount of the transaction relative to debt maturing within three months is considered. For example, in a syndicated bond issuance of $1 billion in which the PMCCF purchases 25% ($250 million), the additional debt ratings reaffirmation requirement would apply if the amount of debt maturing within three months were less than $1 billion. Similarly, if the stated use of proceeds for a transaction includes uses in addition to refinancing, such as general corporate purposes, then the additional debt ratings reaffirmation requirement would apply.

**Will the SMCCF purchase a specific issue of corporate bonds of an Eligible Issuer in the secondary market if the PMCCF participated in the primary issuance of such corporate bonds?**

Both the SMCCF and PMCCF may purchase the same specific issue of corporate bonds of an Eligible Issuer as long as the total purchases are within the limits described herein.

**How will pricing work when the PMCCF is participating in transactions alongside other investors?**

For eligible syndicated loans and bonds purchased at issuance, the PMCCF will receive the same price as other syndicate members, plus a 100 bps facility fee paid by the borrower on the PMCCF's share of the issuance. For example, in a syndicated bond issuance of $1 billion in which the PMCCF purchases 25 percent ($250 million), the issuer must pay a facility fee of $2.5 million at closing.

**What information will the issuer be required to disclose?**

Companies that obtain credit from the PMCCF must make their own determination concerning their disclosure obligations under securities laws. Companies subject to Regulation FD under the Securities Exchange Act of 1934 (the "Exchange Act") cannot expect the PMCCF to agree to maintain in confidence any material nonpublic information provided to it or its investment manager by the company in connection with a sale of bonds to the PMCCF.

For bonds issued pursuant to Rule 144A under the Securities Act of 1933 ("Rule 144A") by an issuer that is not an Exchange Act reporting company, the PMCCF expects that the offering document and indenture for the bonds, and any material nonpublic information with respect to the issuer or its securities distributed to PMCCF (or any other investors) in connection with that offering, will be made available on a website accessible by (i) the PMCCF or any other investor in connection with the relevant distribution and (ii) other prospective purchasers and sellers of bonds of the issuer who are qualified institutional buyers for purposes of Rule 144A.

Issuers and underwriters of bonds are expected to ensure that appropriate disclosure is made of the fees to be paid to PMCCF and the purchase remedy rights of the PMCCF in transactions where the PMCCF is a co-investor.

**What are the additional single-issuer limits for the SMCCF?**
The maximum amount of corporate bonds of a single issuer that the SMCCF will purchase on the secondary market is additionally capped at 10 percent of the issuer's maximum bonds outstanding on any day between March 22, 2019, and March 22, 2020. The SMCCF will not purchase shares of a particular ETF if, after such purchase, the SMCCF would hold more than 20 percent of that ETF's outstanding shares.

**Will the underlying holdings of ETFs be counted towards the issuer limits?**
No.

**If the SMCCF has already purchased corporate bonds of a particular issuer, does it limit the maximum size for that issuer under the PMCCF?**
The total combined amount of the debt of a single issuer to be purchased in the SMCCF and PMCCF is limited as set forth in the term sheets. If the SMCCF purchases a particular issuer's corporate bonds prior to the issuer issuing to the PMCCF, it will reduce the issuer's capacity available under the PMCCF.

**What certifications under section 13(3) of the Federal Reserve Act will be required for the SMCCF to purchase bonds of an issuer?**
Eligible Issuers are not required to provide certifications under section 13(3) for purposes of the SMCCF.

**What certifications under section 13(3) of the Federal Reserve Act will be required for an issuer to borrow from the PMCCF?**
Each Eligible Issuer will be required to provide a written certification that it is unable to secure adequate credit accommodations from other banking institutions and the capital markets and that it is not insolvent. These certifications will be made using the Regulation A certification that is available here.

**For the purposes of participating in the PMCCF, what does it mean for an Eligible Issuer to certify that it is unable to secure adequate credit accommodations?**
The Federal Reserve must obtain evidence that participants in the PMCCF are unable to secure adequate credit accommodations from other banking institutions and the capital markets. In certifying whether the issuer is unable to secure adequate credit accommodations from other banking institutions or the capital markets, issuers may consider economic or market conditions in the market intended to be addressed by the PMCCF as compared to normal conditions, including the availability and price of credit. Lack of adequate credit does not mean that no credit is available. Credit may be available, but at prices or on conditions that are inconsistent with a normal, well-functioning market.

**At what price will the SMCCF purchase corporate bonds in the secondary market?**
The SMCCF will purchase eligible corporate debt at market prices from Eligible Sellers in the secondary market.

**At what price will the SMCCF purchase ETFs?**
The SMCCF will generally not purchase shares of an ETF that were determined to have closed at a premium above the lower of the following limits relative to the prior end-of-day official net asset value (NAV): (a) 1%, or (b) the mean premium observed over the prior 52 weeks, on a rolling basis, plus the 1-standard deviation of the premium for the same period. Additionally, on an intraday basis, the SMCCF will generally limit purchases of eligible ETFs that are trading at levels well above estimates of intraday net asset value (iNAV) as measured during trading hours. These limits will serve the dual purpose of avoiding overpayment for an ETF relative to the cost of purchasing its underlying assets, and avoiding contributing to elevated demand that an ETF may already be experiencing, while affording operational flexibility.

**How does Fed participation in syndicated loan or bond issuances under the PMCCF work?**
When the PMCCF purchases portions of syndicated bond or loan issuances of Eligible Issuers, the PMCCF's participation is expected to be alongside that of other participants, at the same terms and price, with an additional 100 bps facility fee. After a transaction is announced and shown to prospective purchasers, in the event of insufficient demand (i.e., demand for less than 100 percent of the offering) and a desire by the issuer to approach the PMCCF for participation to complete the transaction, the underwriters or initial purchasers may approach the

PMCCF via the investment manager by email to pmccf@blackrock.com with a copy to pmccf@ny.frb.org and request participation by the PMCCF of up to 25 percent of the offering. The PMCCF will apply the 100 bps facility fee on the amount of the PMCCF's participation.

Eligible Issuers under the PMCCF on co-investor and sole investor transactions will be required to certify compliance with the eligibility criteria. The certification forms are available on the New York Fed's PMCCF website.

**What additional documentation is required where the PMCCF invests or co-lends in a bond or loan offering?**

In order to be an Eligible Issuer for the PMCCF, a company must certify compliance with the eligibility criteria set forth in Regulation A and the CARES Act. Under Regulation A or the express terms of the certifications, if a participant in the PMCCF has obtained credit by making a knowing material misrepresentation or a material breach of the use of proceeds provisions, all extensions of credit to that participant will become immediately due and payable. In addition, an Eligible Issuer is required to make other certifications and/or representations in connection with its participation in the PMCCF, including information regarding its outstanding indebtedness, lack of participation in the Main Street Lending Programs, that it is not a depository institution or depository institution holding company (or a subsidiary thereof), and, in certain circumstances, the use of PMCCF proceeds, a material knowing misrepresentation or a material breach of which will result in all extensions of credit to that participant becoming immediately due and payable.

Accordingly, when the PMCCF purchases bonds at issuance, the Eligible Issuer will be required to enter into a CCF Letter Agreement ("Letter Agreement") (available here) under which it will agree to repurchase the bonds sold to the PMCCF upon demand, at the 100% of the outstanding principal amount plus accrued interest, in the event the participant has made any knowing material misrepresentation or there is a material breach of the use of proceeds provisions under the PMCCF program transaction-specific documentation. A similar agreement will be required when the PMCCF participates in a syndicated loan transaction, and the form of agreement will be published at such time as the facility begins transacting in syndicated loans. The indenture or loan agreement for bonds or loans in which the PMCCF is a co-investor or co-lender must provide that any payments to the PMCCF under the Letter Agreement are not subject to any sharing clause or similar provision requiring ratable application of recoveries from an issuer or borrower among noteholders or lenders. In transactions that rely on a guarantee, the guarantor will be jointly and severally liable with the issuer for the repurchase obligation. The execution and delivery of this Letter Agreement is a condition to the PMCCF's purchase of bonds or closing of loans.

**What are the terms required for bonds which are presented to the PMCCF for consideration as the sole investor?**

The indenture or supplemental indenture signed by the issuer and any guarantors for bonds presented to the PMCCF as the sole investor is expected to have terms consistent with market conventions and the issuer's most recent prior bond issuance, but will also be required to incorporate a standard set of terms reflecting minimum covenants and other protections applicable to the PMCCF. These standard terms are available on the New York Fed's PMCCF website. The terms may be updated from time to time, and bonds purchased by the PMCCF as sole investor should include the most recent standard terms as of the date the bonds are issued. If the issuer's most recent prior bond issuance includes more investor-favorable terms than the PMCCF standard terms, such other terms will also be required to be included, as described in the PMCCF standard terms. If an issuer incorporates specific PMCCF standard terms into its own formulation of specified covenants, that formulation is required to encompass all of the restrictions set out in the corresponding standard terms. If all PMCCF standard terms are not included in the indenture or supplemental indenture, the PMCCF may decline to participate in the transaction. The PMCCF standard terms also include a requirement that the rating conditions referenced in the term sheet are included as a condition precedent in the underwriting/purchase agreement.

**Pricing for loans and bonds tend to fluctuate throughout the day of issuance. How will this impact PMCCF participation?**

When the PMCCF purchases portions of syndicated loans or bonds of Eligible Issuers, participation is expected to be alongside that of other participants at the same pricing. However, borrowing under the PMCCF is intended for issuers who are unable to secure adequate credit accommodations. Market pricing should not be lowered for the purpose of decreasing demand from market participants in order to fill deal capacity via the PMCCF.

**What call features will be included in transactions in which the PMCCF is the sole investor?**
Call options will be included in the standard terms available on the New York Fed's PMCCF website. These call features vary based on whether the Eligible Issuer is rated at or above BBB-/Baa3 (or comparable) at the time of issuance or below BBB-/Baa3 (or comparable) at the time of issuance.

**How will the PMCCF determine interest rates when purchasing eligible corporate bonds as the sole investor?**
Pricing will be issuer-specific and informed by market conditions. Specifically, the pricing methodology will take into consideration the spreads above equivalent Treasuries on existing bonds issued by the same or comparable (e.g. by sector, rating) issuers adjusted by tenor (as needed), which would be added to the rate on a comparable maturity on-the-run Treasury. Additionally, a ratings-based concession (spread premium) will be applied to lower rated issuers to account for the likelihood that underwriting fees may reflect a lesser degree of marketing activity and underwriting risk. In each case, an up-front 100 bps facility fee will be charged.

All pricing determinations for sole investor transactions will be made by the PMCCF, and are not subject to bespoke negotiations.

**Are there minimum and maximum spreads for the PMCCF sole investor transactions? How are they calculated?**
Yes. Spreads would be expected to rise in stressed market conditions, but would be capped at spread levels based on historical distributions for each ratings notch. These levels are set around the 95th to 97th percentile of spreads over the past 15 years on three- to five-year senior debt of U.S. firms (excluding banks) to maturity matched on-the-run Treasuries. In all cases, spreads will be floored at or around the 50th percentile of spreads for each ratings notch.

**How is the facility fee paid when the PMCCF is participating in transactions alongside other investors?**
The facility fee of 100 basis points is a requirement for participation and is based on the par amount of PMCCF participation in an offering. The facility fee is to be paid by the issuer; however, for purposes of settlement in a bond offering, the underwriter or initial purchaser serving as Billing and Delivery Agent (B&D Agent) will pay the fee to the PMCCF on the issuer's behalf no later than the close of business on the settlement date. The issuer is responsible for directing the B&D Agent to pay the PMCCF on its behalf. The investment manager will provide documentation to the underwriters at the time of approaching the PMCCF, including details of where to send the payment. Fee payments are to be made by separate wire transfer to the PMCCF and not netted against the purchase price for loans and bonds purchased by the PMCCF.

**What are the criteria for underwriters to be eligible to facilitate a transaction under the PMCCF?**
When the PMCCF purchases eligible corporate bonds, Eligible Issuers are required to utilize two or more underwriters to facilitate the transaction. One or more of the underwriters in the transaction must have significant experience with transactions of the size and complexity possible in the PMCCF, and therefore must have underwritten a minimum of 100 transactions and $10 billion in investment-grade corporate bonds, excluding self-led transactions, in the capacity of active bookrunner between March 22, 2019, and March 22, 2020. This criteria is also required for the Billing & Delivery Agent. The Federal Reserve strongly encourages issuers to utilize minority-, women-, and veteran-owned (MWV) businesses as underwriters in the PMCCF process. Where an MWV does not meet the criteria outlined above, they may still participate in the transaction as an additional underwriter.

**What is the process for requesting investment by the PMCCF in a bond issuance?**
Underwriters or initial purchasers are expected to contact the investment manager by email (pmccf@blackrock.com with a copy to pmccf@ny.frb.org) to request PMCCF participation in a transaction alongside other investors or as the sole investor in a bond issuance. For a sole investor transaction, it is expected that this initial contact would occur approximately two weeks prior to pricing. For a transaction alongside other investors, it is expected that initial contact would occur as soon as the underwriters expect to bring the bond issuance to the PMCCF for consideration, but should not be later than 1:00 p.m. ET on pricing day.

**How will involvement of the PMCCF as an investor affect offering documentation for bonds?**
It is expected that bonds sold to the PMCCF, whether as the sole investor or as a purchaser in a syndicated offering marketed to other investors, will be documented in a manner customary for SEC-registered bond offerings or bond offerings conducted pursuant to Rule 144A. The PMCCF will purchase bonds from underwriters as part of an SEC-

registered offering or from initial purchasers making a Rule 144A resale. The PMCCF will purchase bonds solely as an investor and not as an underwriter or dealer, and will not purchase directly from an issuer or through an arranger acting only as a “placement agent”. For Rule 144A offerings, the PMCCF will expect to receive an offering circular or offering memorandum describing the issuer, the terms and conditions of the bonds, risk factors, and other matters typically addressed in such materials. In connection with all bond issuances involving sales to the PMCCF, it is expected that underwriters/initial purchasers will perform customary due diligence and receive customary closing documents such as auditor comfort letters, legal “10b-5” disclosure letters and legal opinions.

**Should Eligible Issuers expect to pay underwriting fees when the PMCCF purchases eligible corporate bonds as the sole investor in a bond issuance?**
The amount paid for underwriting services will be determined entirely between the Eligible Issuer and the underwriter.

FAQs: July 23, 2020 »

DOCUMENT 2

https://www.wsj.com/articles/federal-reserve-discloses-holdings-of-1-3-billion-in-exchange-traded-funds-11590782661

U.S. ECONOMY

# Federal Reserve Discloses Holdings of $1.3 Billion in Exchange-Traded Funds

ETFs focused on non-investment grade debt account for around one sixth of such fund purchases

The Federal Reserve earlier this month began buying exchange-traded funds that provide broad exposure to U.S. corporate bond markets.

PHOTO: TING SHEN/XINHUA/ZUMA PRESS

*By Nick Timiraos and Sam Goldfarb*
May 29, 2020 4:04 pm ET

The Federal Reserve's first $1.3 billion of purchases of exchange-traded funds that invest in corporate bonds show that funds that focus on buying non-investment grade debt accounted for around one sixth of the central bank's ETF purchases.

The Fed announced plans to backstop debts of investment-grade firms after the coronavirus pandemic led to a deep freeze across credit markets in mid-March, and it subsequently said in April it would backstop debt for so-called fallen angels, or firms that had been rated investment grade as of March 22 but were subsequently downgraded to junk status.

As part of the backstops, the Fed on May 12 began purchasing exchange-traded funds that provide broad exposure to U.S. corporate bond markets. The Fed said the "preponderance" of those holdings would be in funds whose primary investment objective was in the market for debts with investment-grade ratings, but officials said they would allow for some purchases of ETFs with exposure to junk bonds.

The decision to invest in junk debt has been controversial. Some investors have argued that the central bank risked a deeper credit freeze that would lead to higher unemployment if the central bank shunned riskier assets, while others warned that doing so would reward firms and their investors that were already vulnerable to an economic downturn before the crisis due to heavy debt burdens.

The disclosures of 158 transactions cover purchases made between May 12 and 18. Of the Fed's $1.3 billion in ETF holdings as of May 19, around 17% were in funds that invest primarily in junk debt. The funds the Fed invested in have appreciated 2.7% on average since purchases began on May 12, according to Roberto Perli of Cornerstone Macro, a research firm.

The Fed owned $100 million in iShares iBoxx High Yield Corporate Bond ETF, which as of Thursday included small holdings of bonds issued by rental car company Hertz Global Holdings Inc., which filed for bankruptcy protection on May 22. It also included small holdings of retailers J.C. Penney Co. and Neiman Marcus Group Inc. and oil-shale driller Whiting Petroleum Corp. , all of which filed for bankruptcy in recent weeks.

Three ETFs accounted for the majority of the Fed's investments: iShares iBoxx US Dollar Investment Grade Corporate Bond ETF, Vanguard Intermediate-Term Corporate Bond ETF and Vanguard Short-Term Corporate Bond ETF. The Fed can't purchase more than 20% of an ETF's assets.

The Fed owned nearly $3 billion in ETFs as of Wednesday, according to a separate disclosure, representing less than 2% of all U.S.-listed corporate bond ETFs, according to BofA Global Research.

The Fed has said it would purchase up to $250 billion in outstanding corporate debt and up to $500 billion in newly issued debt, but the mere announcement of the lending programs helped sharply reduce borrowing costs for an array of businesses, meaning the facilities may see less use than initially anticipated if markets don't deteriorate again. The

Fed's lending programs aren't fully operational and have so far only conducted ETF purchases.

Fed Chairman Jerome Powell defended the decision to purchase the debt of fallen angels and other non-investment grade companies Friday during an online discussion hosted by Princeton University.

"By announcing our facility and including those companies—the ones who actually needed the credit in March—those companies have now been able to go out and finance themselves, and have now lots of cash on their balance sheets," said Mr. Powell. "They've been able to avoid layoffs. That is the point of all this."

Mr. Powell said disclosing the Fed's purchases would be an important way to demonstrate how it was meeting those goals and to avoid misinformation over where the central bank's loans go.

"Disclosure will really help because I read things in the paper that are supposedly happening, and I know they're not happening," he said. "One reason they're not happening is we actually haven't made very many loans yet."

**Write to** Nick Timiraos at nick.timiraos@wsj.com and Sam Goldfarb at sam.goldfarb@wsj.com

*Appeared in the June 1, 2020, print edition as '.'*

DOCUMENT 3

https://www.wsj.com/articles/fed-hires-blackrock-to-help-calm-markets-its-etf-business-wins-big-11600450267

FINANCE

# Fed Hires BlackRock to Help Calm Markets. Its ETF Business Wins Big.

The central bank's market intervention helped the largest U.S. provider of corporate bond exchange-traded funds get larger

BlackRock CEO Larry Fink has helped the firm grow to $7.3 trillion in assets.

PHOTO: ALEX KRAUS/BLOOMBERG NEWS

*By Cezary Podkul and Dawn Lim*

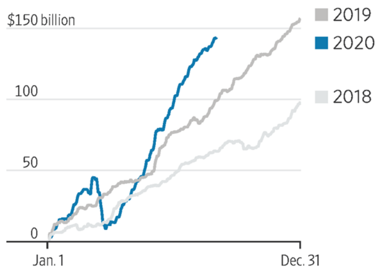
Sept. 18, 2020 1:31 pm ET

Listen to this article
7 minutes

The Federal Reserve's March commitment to deploy billions of dollars to prop up the economy was a boon for the company the Fed hired to help execute its plan: BlackRock Inc., BLK -1.73% ▼ the world's largest asset manager.

In response to the pandemic-induced market collapse, the Fed promised to buy corporate bonds and exchange-traded funds that invest in collections of corporate debt.

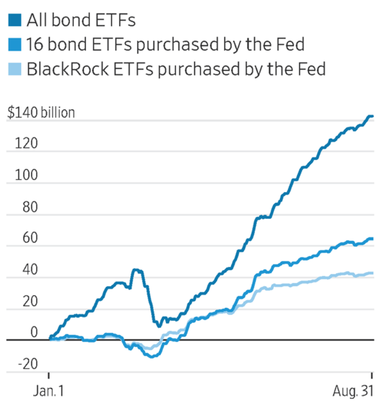
**Cumulative industry net inflows into bond-focused ETFs**




Note: Data denotes universe broader than just corporate bond ETFs. 2020 inflows through August.
Source: Morningstar

The Fed had never bought ETFs or corporate bonds before. The central bank tapped BlackRock to help advise it and buy the bonds and funds on its behalf, though the central bank retained ultimate authority over what to purchase.

**Cumulative net inflows into bond-focused ETFs in 2020**




Source: Morningstar

The Fed's interventions worked as designed, stoking investor confidence and restoring market function—even before the central bank had bought anything at all. But one side effect was that many of the funds investors poured into were BlackRock's own, making the giant firm an even bigger player in the exchange-traded-fund market.

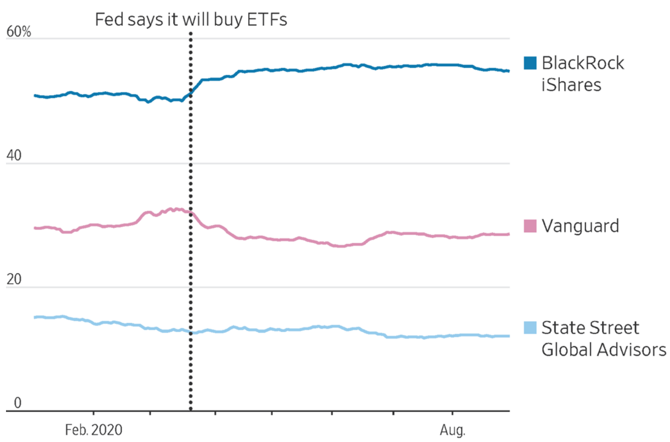
In the days after the Fed's announcement on March 23, traders jockeyed to figure out what funds the central bank might buy, and bought those funds themselves.

BlackRock's share of assets increased in 27 funds Morningstar Inc. analysts deemed potentially eligible for the Fed program. BlackRock's share grew from 51% on March 20 to about 56% on July 23, when the Fed last bought ETFs, according to Morningstar.

The funds the Fed ultimately did buy became even more popular with investors, who put $48 billion into them in the first half of 2020, nearly twice the amount that went in the year before. BlackRock funds were especially popular: They took in $34 billion, about 160% more than in the first half of 2019.

"The unprecedented actions taken by the Fed during Covid-19 just accelerated the trend where the biggest products get bigger," said Linda Zhang, chief executive of Purview Investments in New York.

**Market share within corporate bond ETFs eligible for Fed purchases**




Note: Share by assets of 27 corporate bond ETFs likely to be eligible for the Fed's ETF purchases. Some funds didn't exist over the entire time period.
Source: Morningstar

A $7.3 trillion asset manager run by CEO Laurence Fink, BlackRock was already the largest provider of these kinds of ETFs, which are commonly used by big institutions to enter and exit markets cheaply.

BlackRock President Robert Kapito said that the firm's gains were neither outsize nor surprising.

**BlackRock's share of assets in Morningstar-defined universe of corporate bond ETFs**


Note: Data references a universe of 27 corporate bond ETFs Morningstar determined were eligible for purchase by the Fed. Some funds didn't exist over the entire time period.
Source: Morningstar

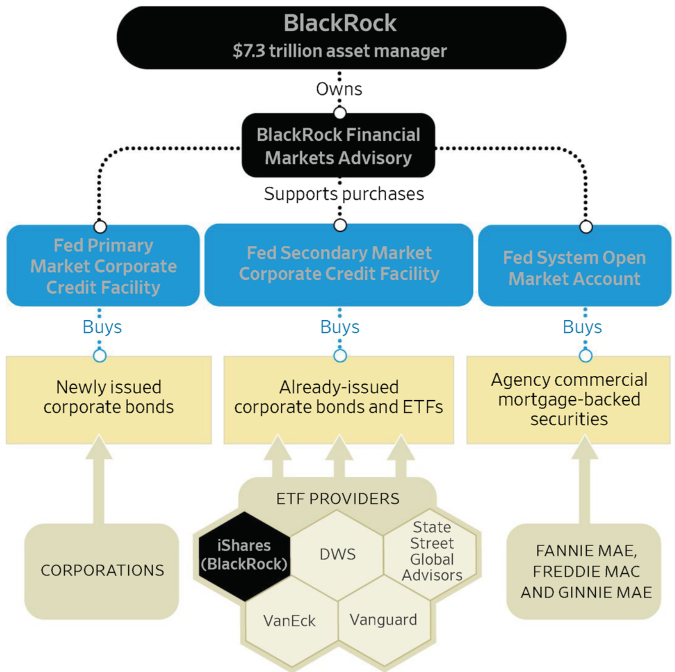
He said the firm's most actively traded corporate bond ETFs draw institutions seeking rapid exposure to markets. This means its market share expands in periods when investors are more likely to take risks and contracts when they become more risk averse, he said.

"The success we've seen in recent years is the result of our strategic investments into the business over time," he said. "We've repeatedly gained market share during periods when these investors increase their risk exposure."

BlackRock's advisory arm aiding the Fed is separate from BlackRock's asset-management arm, which runs its ETF business.

The firm will receive modest compensation for its role assisting the Fed—a roughly $3 million fee for the six months ending Sept. 30, and $750,000 per quarter thereafter, according to BlackRock's contract with the Fed. BlackRock will also collect fees on the small corporate bond portfolio it manages for the Fed. BlackRock isn't charging any fees on ETFs and is rebating fees from its own iShares ETFs back to the Fed. The central bank limited the amount of BlackRock ETFs it would buy.

**BlackRock's involvement in the Federal Reserve's interventions in markets**



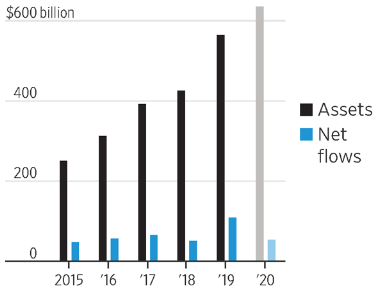

Note: Fannie Mae, Freddie Mac and Ginnie Mae refer to the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association, respectively.
Sources: BlackRock; Federal Reserve

Of the 16 ETFs the Fed ultimately purchased, eight were BlackRock's iShares funds. BlackRock, Vanguard Group and State Street Global Advisors made up 99% of the Fed's ETF portfolio, valued at $8.7 billion as of August. Two remaining funds were managed by smaller competitors DWS and VanEck.

The thaw in markets meant the Fed only spent about $13 billion of the up to $750 billion it had designated for corporate-bond and ETF buying.

While BlackRock is set to earn a relative pittance from the Fed, it made millions in fees from other investors.

**BlackRock iShares bond ETF assets and flows**




Note: 2020 data are as of June 30. Data denote universe broader than corporate bond ETFs.
Source: Company filings

"Even if BlackRock waives its fees from the purchases that the Fed is making, the fact that it is associated with this program means that other investors are going to rush into BlackRock funds," said Bharat Ramamurti, a member of the congressional body overseeing the Fed's coronavirus stimulus programs, who also worked for Elizabeth Warren's presidential campaign.

"BlackRock obviously generates fees from those flows. So the net result is that this is very lucrative for BlackRock," Mr. Ramamurti said.

BlackRock's popular ETF that trades under the ticker LQD saw $8.2 billion of inflows in the first seven trading days after the Fed's March announcement, Morningstar estimates show. The Fed didn't start buying any funds until May.

BlackRock charges 0.14% in fees for LQD, or $14 for every $10,000 invested.

Across all categories of iShares bond ETFs, beyond just corporate bonds, BlackRock's revenue rose 11.5% to $261 million in the second quarter from the same period last year.

The Santa Monica, Calif., asset manager Angeles Investments bought about 90,000 shares of LQD in the two days after the Fed's announcement.

"It's not that complicated, really. The Fed says, 'We're buying this.' OK, then, I'm going to buy it too," said Michael Rosen, chief investment officer of Angeles Investments.

Mr. Rosen said he picked the fund because of its size and liquidity. His firm had also bought about 45,000 shares of LQD on March 16.

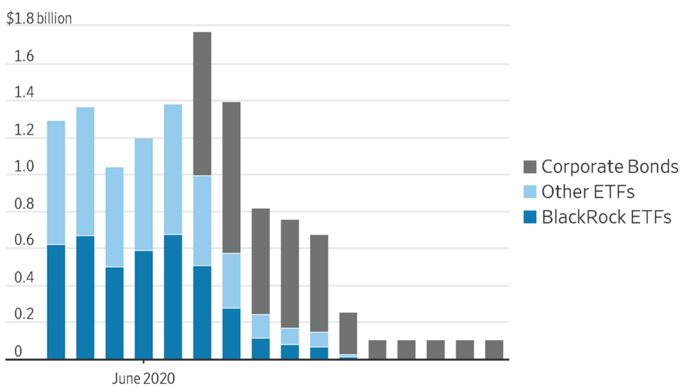


Columbia Threadneedle Investments snapped up seven million LQD shares in March, nearly doubling its position to about 4% of LQD's shares outstanding, FactSet data show. Wisconsin's state pensions system bought a million shares. Some actively managed BlackRock portfolios also increased their exposure to LQD and to several other bond ETFs managed by the firm, FactSet data show.

State Street published a list of seven potential candidates across State Street's, Vanguard's and BlackRock's offerings—and the guesses were all correct, including BlackRock's LQD.

"If I only had the same luck with picking fantasy baseball players," said Matthew Bartolini, who heads Americas research at State Street's ETF division.

Weekly purchases by Federal Reserve




Note: Purchase amounts by security type within the Fed's Secondary Market Corporate Credit Facility.
Source: Federal Reserve Bank of New York

**Write to** Cezary Podkul at cezary.podkul@wsj.com and Dawn Lim at dawn.lim@wsj.com

*Appeared in the September 19, 2020, print edition as 'BlackRock Makes Hay Helping Fed.'*

# DOCUMENT 4

Yale SCHOOL OF MANAGEMENT

## Program on Financial Stability

Improving our understanding and management of systemic risk.

# Despite Stated Exclusion, the Fed Is Buying Bank Debt

PROGRAM ON FINANCIAL STABILITY

- COVID-19 Crisis
- About
- New Bagehot Project
- Journal of Financial Crises
- The Global Financial Crisis, Charts and Data

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September 21, 2020
BY STEVEN KELLY

The Federal Reserve has said it won't directly buy bonds issued by banks as part of its COVID financial rescue facilities. But a close review of its holdings reveals that by buying exchange traded funds, it has indirectly bought $2 billion of bank bonds – over 15% of its total corporate bond holdings.

The Fed unveiled two facilities to purchase corporate bonds on the primary and secondary markets in March, as the growing pandemic roiled financial markets, causing selloffs across risk assets and impeding the financial intermediation of dealers and lenders.

The two facilities are the Primary Market Corporate Credit Facility (PMCCF) and Secondary Market Corporate Credit Facility (SMCCF). The Treasury originally capitalized them with existing funds in its Exchange Stabilization Fund (ESF). It later replaced those funds with new, specific ESF funds allocated by the CARES Act.

The Fed designed the PMCCF and SMCCF to leverage the capital provided for loss protection by the new Treasury funds into up to $500 billion of new corporate bond purchases and $250 billion of secondary market corporate bond purchases. For a full description of the PMCCF and SMCCF, see here and here.

While, to date, no firms have issued bonds to the PMCCF, the SMCCF has purchased securities on the open market. It has bought investment-grade and high-yield corporate bond exchange-traded funds (ETFs) since May, and a portfolio of individual-name corporate bonds that tracks a broad market index since June. As of the Fed's September 8 report of its August 31 holdings, the SMCCF holds over $12 billion of corporate bonds and corporate bond ETFs. It has considerably slowed its purchases given the recent calm in bond markets.

### Buying Bank Bonds through ETFs

When the Fed laid out its terms for the purchase of corporate bonds, it said it would only buy the bond of "an issuer that is not an insured depository institution, depository institution holding company, or subsidiary of a depository institution

CATEGORIES

- Systemic Risk News
- US
- Market Liquidity
- SME
- CARES Act
- Analyses of Specific Interventions
- Market Commentary
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holding company." Following that policy, none of the Fed's purchases of individual-name bonds in the secondary market have been bank bonds.

However, the Fed said that ETFs it purchased wouldn't be held to the same criteria as individual bonds. According to the Fed's initial terms for the SMCCF: "In some cases...ETFs may include underlying bonds that have a remaining maturity longer than 5 years at the time of purchase, or include underlying bonds that would otherwise be ineligible for purchase by the SMCCF."

This made it clear that the Fed might buy ETFs that held bank debt. Indeed, banks make up 21% of the investment-grade credit market, based on the industry-standard ICE/BofA corporate credit indexes. It should be expected that ETFs designed to broadly track that market would include some bank debt.

However, given that it was excluding bank debt from its individual corporate bond purchases, the Fed also explicitly said that it would consider "the amount of debt held in depository institutions" in an ETF before making a purchase decision. Yet, when looking at outcomes, it's not clear that this restriction has been binding.

Unlike with its individual-name bond holdings, the Fed does not provide a breakdown of the industry allocation of its ETF holdings. However, it is possible to deduce that allocation by reviewing the public disclosures that ETF managers provide.

Based on August 31 data, the Fed held just over $7.5 billion of investment-grade ETFs. Those ETFs, in turn, held $7.5 billion in bonds, of which about $2 billion, or 26%, were bank bonds. (There is also a slim percentage of bank holdings—less than $20 million—in the Fed's holdings of high-yield ETFs. It is uncommon for banks to be rated below investment-grade: banks make up just 2% of the high-yield bond market, per ICE/BofA.)

Based on a review of public filings, eight of the nine investment-grade ETFs the Fed has bought have a higher allocation to banks than the market benchmark of 21%. Three of the nine have bank weightings exceeding 30%, and two have weightings of 35%.

| Ticker | Fund Name | Federal Reserve Holdings - Market Value as of August 31, 2020 (US $) | Bank allocation as of 9/14 | Implied bank holdings (US $) |
|---|---|---|---|---|
| IGIB | iShares Intermediate-Term Corporate Bond ETF | 492,137,395 | 22% | 109,500,570 |
| IGSB | iShares Short-Term Corporate Bond ETF | 685,785,992 | 30% | 206,284,426 |
| LQD | iShares iBoxx US Dollar Investment Grade Corporate Bond ETF | 2,421,905,903 | 23% | 568,179,125 |
| SLQD | iShares 0-5 Year Investment Grade Corporate Bond ETF | 43,993,194 | 35% | 15,221,645 |
| SPIB | SPDR Portfolio Intermediate Term Corporate Bond ETF | 486,263,580 | 27% | 129,200,233 |
| SPSB | SPDR Portfolio Short Term Corporate Bond ETF | 281,438,678 | 35% | 99,010,127 |
| USIG | iShares Broad US Dollar Investment Grade Corporate Bond ETF | 183,094,061 | 19% | 34,604,777 |
| VCIT | Vanguard Intermediate-Term Corporate Bond ETF | 1,433,807,901 | 23% | 330,922,864 |
| VCSH | Vanguard Short-Term Corporate Bond ETF | 1,515,313,576 | 31% | 465,807,393 |
| **All Investment-Grade ETFs** | | **7,543,740,279** | **26%** | **1,958,731,161** |

*Sources: Federal Reserve, Bloomberg, author calculations*

The result is that, despite the self-imposed restriction against buying individual bank bonds, over 26% of the SMCCF's ETF holdings and 15% of its total holdings are claims on bank bonds.

### Unprecedented?

The federal government has borne the credit risk of term bank bonds before. In 2008, during the Global Financial Crisis (GFC), the Federal Deposit Insurance Corporation (FDIC) rolled out its Debt Guarantee Program (DGP). For participating banks, the FDIC extended the full faith and credit of the U.S. government to guarantee privately issued bank debt in exchange for a fee – akin to an insurance premium. The program peaked at $350 billion of issuance, collecting $10.4 billion in premiums and paying out $153 million to cover defaults.

However, following post-crisis legislative reforms, such guarantees now require explicit Congressional approval, in addition to the pre-existing requirements for approval from the Fed, FDIC, and Treasury in consultation with the President.

Via these ETF purchases, the market for bank debt is receiving federal support, if on a much smaller scale. The Fed has said that if financial market volatility picks up again during this pandemic, both ETF purchases and individual bond purchases would be scaled back up. Under such circumstances, the Fed's holdings of bank bonds would be expected to grow as well.

Yet, with the SMCCF currently capped at $250 billion (and lower to the extent it includes high-yield assets, which it's leveraging at a lower ratio) and bank bonds representing just a fraction of holdings, the total amount of federally-supported bank debt would remain a fraction of the peak outstanding DGP debt during the GFC, and the credit risk-bearing would not be as targeted. That is assuming no major expansion of the facility, shift to buying bank-only ETFs, or some similar repurposing takes place.

**Categories**

US Market Liquidity Bank Debt Emergency Liquidity

**What to read next**

**News in Systemic Risk: Thursday, November 12, 2020 (10 a.m. ET)**

November 12, 2020 PROGRAM ON FINANCIAL STABILITY

**News in Systemic Risk: Tuesday, November 10, 2020 (10 a.m. ET)**

November 10, 2020 PROGRAM ON FINANCIAL STABILITY



**Systemic Risk: Monday, November 9, 2020 (10 a.m. ET)**

KATIE PORTER
45TH DISTRICT, CALIFORNIA

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INVESTOR PROTECTION, ENTREPRENEURSHIP,
AND CAPITAL MARKETS

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October 21, 2020

The Honorable Jerome Powell
Chairman of the Board of Governors
Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chairman Powell:

I write regarding reports that the Federal Reserve System (Federal Reserve) is using billions of taxpayer dollars to purchase the debt of banks like JPMorgan Chase. These purchases are in direct contravention of the Federal Reserve's own statement that it would *not* be purchasing the debt of any "insured depository institution, depository institution holding company, or subsidiary of a depository institution holding company"—also known as: banks.[1]

The Federal Reserve's decisions to 1) for the second time in twelve years, use taxpayer dollars to backstop bank debt and 2) appoint the CEO of BlackRock to administer the largest corporate bailout in history has resulted in windfall profits for a few hand-selected corporations and eroded public faith in an institution that is foundational to our democracy. To begin to remedy these wrongs, I request that you immediately develop and implement stronger safeguards against conflicts of interest. The profits that BlackRock has made off the exchange-traded funds (ETF) market since your March 23 announcement that the Fed would begin to purchase ETFs that invest in bank debt[2] are clear evidence that any current precautions are wholly insufficient.

[1] Federal Reserve Bank of New York, "FAQs: Primary Market Corporate Credit Facility and Secondary Market Corporate Credit Facility" at: https://www.newyorkfed.org/markets/primary-and-secondary-market-faq/corporate-credit-facility-faq
[2] Nick Timiraos, "Fed Unveils Major Expansion of Market Intervention" *Wall Street Journal* (March 23, 2020) at: https://www.wsj.com/articles/federal-reserve-announces-major-expansion-of-market-supports-11584964844

According to a Yale School of Management report (the Report) issued on September 21 of this year and entitled: "Despite Stated Exclusion, the Fed Is Buying Bank Debt," the Federal Reserve is defying its own public commitments and buying bank debt with the money that Congress allocated to it in the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Congress allocated $500 billion to the Federal Reserve and the Department of the Treasury with the intent that the Federal Reserve and the Treasury use those funds to minimize the financial downturn sparked by the coronavirus pandemic.[3]

The Federal Reserve put a large portion of those taxpayer dollars into a lending facility called the Secondary Market Corporate Credit Facility (SMCCF), initially funded with $25 billion.[4] The bundles of securities that the Federal Reserve has been purchasing with the money in the SMCCF are called exchange-traded funds (ETFs). Steven Kelly writes in the Report: "a close review of its holdings reveals that by buying exchange traded funds, [the Federal Reserve] has indirectly bought $2 billion of bank bonds—over 15% of its total corporate bond holdings."[5] Per a report issued on September 8 by the Federal Reserve, the SMCCF holds over $12 billion in corporate bonds and corporate bond ETFs.[6]

Compounding your decision to allow the central bank of the United States to purchase these ETFs, your decision to give the CEO of the world's largest issuer of ETFs the ability to invest taxpayer money into his own company is indefensible. Allowing a private corporation and that corporation's wealthy executives and investors to enrich themselves with taxpayer dollars that Congress set aside for pandemic relief makes painfully clear that the priorities of the federal government are with Wall Street, not the American people. Rather than investing more in unemployment insurance or PPE for frontline workers, the government is juicing corporate profits, and it is doing so at the expense of helping the millions of Americans who are struggling to pay rent and buy food.

Your decision to buy corporate debt with taxpayer dollars directly benefited Wall Street and the world's richest corporate executives. However, it also indirectly benefited corporate America by attracting investors to the chosen ETFs. Knowing that the U.S. government would be pouring billions of taxpayer dollars into ETFs was a clear sign to investors that the ETFs tapped by the Federal Reserve would be lucrative, at least in the short term. The announcement in March by the Federal Reserve that it would begin purchasing corporate debt corresponded over the course of the next 7 trading days with investors pouring $8.2 billion into a BlackRock ETF.[7]

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[3] Steven Kelly, "Despite Stated Exclusion, the Fed Is Buying Bank Debt," *Yale School of Management: Program on Financial Stability* (Sept. 21, 2020) at: https://som.yale.edu/blog/despite-stated-exclusion-the-fed-is-buying-bank-debt
[4] Id.
[5] Id.
[6] Id.
[7] Cezary Podkul and Dawn Lim, "Fed Hires BlackRock to Help Calm Markets. Its ETF Business Wins Big," *Wall Street Journal* (Sept. 18, 2020) at: https://www.wsj.com/articles/fed-hires-blackrock-to-help-calm-markets-its-etf-business-wins-big-11600450267

As we have been made all too aware in recent years, public faith in our democracy is imperative to its healthy functioning. Public perception of institutions that comprise our democracy, like the nation's central banking system, forms the foundation of that faith. No matter the justification, using billions of taxpayer dollars to play kingmaker on Wall Street—effectively awarding billions of dollars to a handful of corporations—using a decision-making process that you have not made public, appears corrupt. This is illustrated by a cursory review of the public comments posted on the Wall Street Journal's website in response to the September 18 article entitled: "Fed Hires BlackRock to Help Calm Markets. Its ETF Business Wins Big." These comments range from "something about this just feels wrong" to "this is wrong on so many levels … the analogy you could use is, 'giving the fox the keys to the hen house" to "wow, a fed move benefits one crony outfit. Who could have possibly expected that?" to "no con-fink of interest here."[8]

The mere appearance of corruption may not be enough to justify altering monetary policy decisions. The Federal Reserve was constitutionally designed to resist external pressures, which is why you and the Board of Governors of the Federal Reserve are appointed and not elected. However, it is imperative to the health of our democracy that investments of public dollars are made within the bounds of carefully crafted precautions to prevent self-dealing.

I request that the Federal Reserve immediately develop and implement effective safeguards against conflicts of interest, as any precautions that you are currently employing are not sufficient to prevent and have not prevented unjust enrichment. I also ask that you create and provide a detailed plan to build within the career staff of the Federal Reserve the level of expertise necessary to guide the central bank through the next financial crisis without outsourcing corporate bailouts to Wall Street.

Responsibly wielding the Federal Reserve's significant influence on the markets while upholding the mission of the institution requires careful policymaking, a skill that you have repeatedly demonstrated. You are capable of restoring some measure of public faith in the nation's central bank. I ask that you do so and that you provide an update as to those efforts by October 30.

Very Truly Yours,

Katie Porter
Member of Congress

[8] Id.

**Chairwoman Waters**

**Mortgage Forbearance**

2. For all four witnesses, Section 4013 of the CARES Act requires federal depository regulators to allow lenders to suspend certain accounting requirements related to loan modifications and troubled debt restructurings (TDRs), and Section 4022 of the CARES Act establishes consumer rights to be granted forbearance for federally insured mortgages. The TDR provision will soon expire, but the pandemic continues to inflict considerable damage to our economy on top of the lives that have been lost. One of the bills we are considering today, the Protecting Consumers and Small Businesses through Forbearance Act, would extend the TDR provision under the CARES Act through next June while also requiring these institutions to provide forbearance and loan modifications to consumers and small business owners. What are your agencies doing to encourage banks and credit unions to do all they can to help consumers and small business owners that need forbearance on their obligations?

Response: As we have done since early in the pandemic, the OCC continues to encourage OCC-supervised financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of COVID-19. Along with the other federal banking agencies, the OCC views loan modification programs as positive actions that can mitigate adverse effects on borrowers due to COVID-19. The OCC will not criticize institutions for working with borrowers in a safe and sound manner.

**Asset Thresholds and Participation in the PPP**

3. For all four witnesses, some depository institutions have expressed concern that their participation in the Paycheck Protection Program (PPP) will temporarily push them over regulatory asset thresholds, subjecting them to additional regulation until those loans are forgiven by the Small Business Administration (SBA). Do you share these concerns?

4. The Committee considered two bills that attempt to address this concern as part of this hearing. The first is the Asset Calculation Flexibility to Support Small Businesses Act, which would exempt PPP loans from these calculations through next March, with the intention to allow forgiven PPP loans to roll off a bank's balance sheet while not exempting PPP loans that are not forgiven and will need to be repaid over the next 2 to 5 years. The other is H.R. 8675, the Preventing Regulatory Penalties for PPP Lenders Act, which would exempt all PPP loans, regardless if they are forgiven or not, and limits the application to institutions with less than $15 billion in total assets. Do you have the authority to exempt PPP loans from total assets for the purposes of regulatory thresholds, or would that authority have to be granted in new legislation?

Response Q3 and Q4: The OCC is mindful of the impact to some banks that, by virtue of their participation in the Paycheck Protection Program, cross certain asset-based thresholds in our regulations. The OCC, in coordination with the Board of Governors of the Federal Reserve

System (Board) and the Federal Deposit Insurance Corporation (FDIC), has taken action to address this issue and continues to evaluate options to use our discretionary authority regarding asset-based regulatory thresholds. On December 2, 2020, the agencies issued an interim final rule (IFR) to temporarily mitigate transition costs related to the pandemic on community banking organizations with less than $10 billion in total assets. To provide this regulatory burden relief, the rule temporarily changes, for a number of asset-based regulatory thresholds, the date as of when a community banking organization measures its assets for the purpose of determining whether it exceeds a threshold. The IFR provides OCC-supervised institutions with temporary relief from the following asset thresholds:

- the $10 billion threshold in the Community Bank Leverage Ratio at 12 CFR 3.12;
- the $10 billion threshold in the Board's debit card interchange fee regulation at 12 CFR 235.5;
- the $5 billion threshold for eligibility for reduced reporting requirements for the call report at 12 CFR 52.2; and
- the $3 billion threshold for eligibility for an 18-month examination cycle at 12 CFR 4.6(b) and 4.7(b).

The Federal banking agencies also issued an IFR on April 13, 2020, that permitted banking organizations to exclude PPP loans pledged as collateral to the Federal Reserve's Paycheck Protection Program Liquidity Facility (PPPLF) from a banking organization's measure of average total consolidated assets for purposes of the leverage ratio. The IFR was finalized without change on October 28, 2020.

In addition, in my role as a member of the FDIC's board, I voted to approve another interim final rule allowing banks to use consolidated total assets as of December 31, 2019, to determine applicability of various audit requirements in 12 CFR Part 363 for bank fiscal years ending in fiscal year 2021. This will provide some relief to community banks temporarily crossing over the $500 million and $1 billion total asset thresholds.

These three interim final rules were adopted through the exercise of the agencies' existing regulatory authorities and addressed many thresholds most impactful to community banks. The OCC expects its existing regulatory and exemptive authorities will be sufficient to address current concerns with banks crossing asset thresholds due to participation in PPP and other COVID-19 pandemic relief activities.

**Supporting Minority Communities**

4. For all four witnesses, several studies have shown that communities of color are disproportionately affected physically and economically by the COVID-19 pandemic. According to a Federal Reserve Bank of New York report, Black businesses experienced the most acute decline, with a 41 percent drop. Latinx business owners fell by 32 percent and Asian business owners dropped by 26 percent. In contrast, the number of white business owners fell by 17 percent. What has your agency done to mitigate the impact of the pandemic for your minority

workforce? What has the agency done to support minority communities economically during this pandemic?

Response: The OCC and other bank regulatory agencies have sought to mitigate the impact of the COVID-19 pandemic on small businesses, including minority-owned businesses, as well as America's low- and moderate-income communities, including communities of color, through the issuance of guidance encouraging financial institutions to meet the financial services needs of their customers affected by COVID-19. The guidance clarifies that banks will receive favorable Community Reinvestment Act (CRA) consideration for offering payment accommodations, such as allowing borrowers to defer or skip payments or extending the payment due date, as well as expanding the availability of short-term, unsecured credit products to their creditworthy customers.

The guidance clarifies that prudent efforts to modify the terms on new or existing loans for affected low- and moderate-income customers, small businesses, and small farms will receive CRA consideration and not be subject to examiner criticism. The guidance also states that financial institutions may also receive CRA consideration for easing terms for new loans to affected low- and moderate-income customers, small businesses, and small farms, consistent with prudent banking practices.

Though not directly related to the pandemic, the OCC also established Project REACh in July 2020, to bring together heads of banking, community, civil rights, technology, and business organizations to identify and reduce specific barriers that prevent full, equal, and fair participation in the nation's economy. Project REACh convenes people with the ability to help reduce inherent policy and structural obstacles so underserved populations may have the same opportunities to succeed and benefit from the nation's financial system as others. Project REACh involves three primary national work streams:

- Inclusion for credit invisibles. Project REACh intends to work with technology partners to synthesize a credit score from alternative data, and the OCC could validate such a score for banks to use. This will help tear down a major barrier to economic access for millions.
- Revitalization of Minority Depository Institutions (MDIs). Project REACh intends to explore partnerships among MDIs and other banks to provide a stable source of capital and investment and provide training, exchange programs, and mentorship opportunities to MDI executives and board members. On December 3, the OCC announced the release of the Project REACh MDI pledge which encourages all large and midsize banks to consider the pledge to develop meaningful partnerships with MDIs to help them remain a vibrant part of the economic landscape and better promote fair, equal, and full access to financial products and services in their communities. To date, five banks have signed the pledge: Citibank, NA, Flagstar Bank, Huntington Bank, Texas Capital Bank, and Wells Fargo Bank, NA.
- Increase inventory and accessibility of affordable housing. Project REACh intends to work with financial institutions and major civil rights and community-based

organizations to develop down payment products that provide a bridge to obtaining the American dream of owning a home.

In addition to these national projects, Project REACh includes regional and local projects that focus on developing regional solutions to reduce barriers to economic access for minority communities.

7. Acting Comptroller Brooks, In December 2018, when the OCC and FDIC issued a Notice of Proposed Rulemaking (NPRM) on Comptroller Otting's proposal, the Federal Reserve did not join this proposal. FDIC Board Member Martin Gruenberg voted against Comptroller Otting's proposal, describing it as, "a deeply misconceived proposal that would fundamentally undermine and weaken the Community Reinvestment Act." And in previous remarks, Federal Reserve Board Governor Lael Brainard, said that, "Given that reforms to the CRA regulations are likely to set expectations for a few decades, it is more important to get the reforms done right than to do them quickly. That requires giving external stakeholders sufficient time and analysis to provide meaningful feedback on a range of options for modernizing the regulations." However, despite widespread concern about the OCC's approach to the Community Reinvestment Act, former Comptroller Otting unilaterally issued a problematic final rule on May 20, 2020. Why have you not reversed the OCC's misguided approach that your predecessor forced upon the American people? Will you commit to stopping any further unilateral action on the CRA, including the issuance of any additional notice of proposed rulemaking on CRA benchmarks, and commit to working with the other CRA regulators on a new proposal?

Response: For many years leading up to the OCC's issuance of a final rule in June 2020, stakeholders acknowledged that the CRA regulations needed to be modernized and improved to ensure that lending, investments, and services are directed effectively to communities that insured depository institutions serve. Prior to the OCC's publication of an advance notice of proposed rulemaking in September 2018, the OCC engaged extensively with our partners at the Board of Governors of the Federal Reserve System (Board) and the Federal Deposit Insurance Corporation (FDIC) as well as stakeholders representing a variety of perspectives. The OCC also analyzed feedback on the CRA regulatory framework as part of the Economic Growth and Regulatory Paperwork Reduction Act decennial review process and considered the findings and recommendations of the U.S. Treasury Department in an April 2018 report.

The final rule published in June 2020 builds on and reflects extensive feedback gathered during the rulemaking process. The OCC acted to strengthen CRA regulations in a manner intended to benefit the communities that national banks and savings associations (banks) serve. Specifically, the final rule (1) clarifies what activities qualify for CRA credit; (2) updates how banks delineate areas to be assessed for CRA performance; (3) improves the evaluation process for the largest banks to be more objective; and (4) provides for transparent and timely reporting of key performance data. The banks that OCC supervises conduct a majority of all CRA activity.

It is important that the benefits of the new rule reach communities as soon as possible. The OCC continues to prioritize this goal; on December 4, 2020, the OCC published a notice of proposed rulemaking to request comments on its proposed approach for determining the CRA evaluation measure benchmarks, retail lending distribution thresholds, and community development minimums under the general performance standards. The proposal also solicits comment on the OCC's proposed approach for assessing significant declines in banks' CRA activities levels following the initial establishment of these benchmarks, thresholds, and minimums.

The CRA statute does not require the OCC, Board, and FDIC to conduct joint rulemaking activities. I remain open to all ideas to ensure that CRA remains an effective and powerful tool for strengthening the communities that insured depository institutions serve.

**Efforts to Promote Diversity within the Prudential Regulators**

9. For all four witnesses, the Rooney Rule is a policy that originates from the National Football League, where at least one minority and/or woman must be considered for each open leadership position. This Committee recently passed legislation, H.R. 281, Ensuring Diverse Leadership Act sponsored by Rep. Beatty, that would require the consideration of at least one person reflective of both gender and racial or ethnic diversity when filling Federal Reserve Bank president vacancies. At the hearing, we also considered two other pieces of legislation – the Federal Reserve Bank Board Diversity Act and the Diversity in Financial Regulatory Advisory Committees Act – that would require consideration of at least one candidate that reflects gender diversity and one candidate that reflect racial diversity for Federal Reserve Bank boards of directors, as well as advisory committees for certain financial agencies. How could a Rooney Rule-like requirement to mandate the consideration of diverse candidates for senior staff roles improve diversity results in your agencies? How have you worked with your respective directors of the Office of Minority and Women Inclusion to increase the representation of women and minorities at all levels of your agency?

Response: As Acting Comptroller of the Currency, I work closely with Joyce Cofield, the Executive Director of the OCC's Office of Minority and Women Inclusion, on issues related to increasing the diversity of the OCC's workforce at all levels. Ms. Cofield and I meet weekly, and she is an active participant in the Executive Committee's talent management discussions. The focus of the OCC's talent management efforts is to increase diversity in the pipeline of our major job series. When considering external job applicants, the OCC's goal is an applicant pool in which diversity reflects either the general civilian labor force or the occupational job series availability, whichever is applicable. When considering internal applicants, the agency's goal is an applicant pool in which diversity reflects either the OCC's workforce population as a whole or its population in the specific occupation or job series. The OCC welcomes any changes in the law that would enhance the agency's ability to increase its workforce diversity.

**Rent-a-Bank Partnerships that Harms Consumers**

10. Acting Comptroller Brooks, late last month, the OCC issued its True Lender rule, which would allow a triple-digit interest rate lender to ignore state interest rate limits merely by putting the partnered bank's name on the loan paperwork. As you know, 45 states plus the District of Columbia limit the interest rates on installment loans and now 17 states and DC limit interest rates at 36 percent or below for payday loans. In this latest election, about 83 percent of Nebraska voters approved a measure that establishes a 36 percent interest rate cap on payday loans, following similar votes in favor of rate caps in recent years in South Dakota, Colorado, Montana and other states. Can you explain why you are creating express pathways for triple-digit interest rate lenders to ignore the state rate cap the people of Nebraska overwhelmingly voted to enact to protect their consumers? Why should one rogue bank in another state be allowed to help predatory lenders evade state rate caps approved by voters or their elected state legislatures?

Response: Existing federal statutes, 12 U.S.C. 85 and 1463(g), allow national banks and federal savings associations (banks) to charge interest on any loan at the rate permitted by the state where the bank is located. The OCC's rule, 12 CFR 7.1031, simply establishes a clear and simple test to determine when a bank makes a loan and is the "true lender." If the bank is the true lender, the permissible interest rate will be determined by 12 U.S.C. 85 or 1463(g). Accordingly, disparities between the interest caps applicable to particular bank loans result primarily from these federal statutes and differences in the state laws that impose interest caps, not from an evasion of state law. Further, the OCC's rule does not apply to nonbank lenders or affect the permissible interest rate for the loans they make. In addition, the OCC is confident that existing statutes and regulations, enforceable guidelines, guidance, and enforcement authority provide robust and effective safeguards against predatory lending when a bank exercises its lending authority.

11. Acting Comptroller Brooks, the OCC claims that its supervision of the banks will ensure responsible lending. Yet the OCC supervises Axos Bank, and Axos has been sued multiple times for predatory practices in connection with small business loans by World Business Lenders at rates up to 139% that have led many small business owners to lose not only their businesses but also their homes. Do you think that oversight by the OCC will keep the abuses of rent-a-bank loans in check? If so, how?

Response: It would be inappropriate to comment on specific bank matters. However, the OCC has repeatedly emphasized that inappropriate rent-a-charter lending schemes—arrangements in which a bank receives a fee to rent its charter and unique legal status to a third party—have no place in the federal banking system. These schemes are designed to enable the third party to evade state and local laws, including some state consumer protection laws, and to allow the bank to disclaim any compliance responsibility for the loans. The OCC's rulemaking addresses these schemes by holding banks accountable for all loans they make, including those made in the context of marketplace lending partnerships or other loan sale arrangements. As noted above, the OCC's statutes and regulations, enforceable guidelines, guidance, and enforcement authority provide robust and effective safeguards against predatory lending when a bank exercises its lending authority. If a bank fails to satisfy its compliance obligations, the OCC will not hesitate to use its enforcement authority consistent with its longstanding policy and practice.

12. Acting Comptroller Brooks, in the early 2000s, storefront payday lenders started making loans in states that forbid payday loans by putting a bank's name on the paperwork and claiming that doing so makes the bank the lender and thereby makes the loan exempt from state lending laws. This loophole is allowed under OCC's new true lender rule. Why should merely putting a bank's name in the fine print be enough to claim that it is a bank loan exempt from state lending laws?

Response: The OCC's rule provides that a bank makes a loan when it, as of the date of origination, (1) is named as the lender in the loan agreement or (2) funds the loan. Where one bank is named as the lender in the loan agreement and another bank funds the loan, the bank named as the lender makes the loan.

When a bank is named in a loan agreement, the OCC views this imprimatur as conclusive evidence that the bank is exercising its authority to make loans and has elected to subject itself to the panoply of laws that govern bank lending. As explained above, this test helps solve the problem of inappropriate rent-a-charter relationships by ensuring that stakeholders understand when a bank has made a loan and, consequently, when the OCC's robust legal and supervisory framework applies.

16. Acting Comptroller Brooks, the OCC began proposing a fintech charter a few years ago. What are some of the key differences between the fintech charter initially proposed by the agency in 2016 and the new payments charter you announced earlier this year? Is there overlap in the types of companies that could apply for both charters? Under what specific legal authority does the OCC plan to enforce such charters?

Response: The OCC has the authority to charter, as a national bank, any entity that will be engaged in the business of banking. See 12 USC 21-27. The OCC's authority includes chartering banks that will offer the full range of bank products services and those with a narrower focus, such as national banks that limit their operations to those of a trust company and so-called "special purpose national banks" that engage in one or more core banking activity. See 12 USC 27(a) and 12 CFR 5.20(e)(1). A company that engages primarily in lending and a company that engages primarily in payments would, if eligible, both receive a national bank charter, just as a company that limits its operations to those of a trust company would receive a national bank charter. There is only one national bank charter.

As with any national bank with a narrow focus, a lending company or a payments company that receives a national bank charter would have the same responsibilities and obligations as other national banks, including compliance with capital rules, BSA/AML obligations, establishing appropriate governance, and risk management frameworks, and financial inclusion considerations and requirements. The OCC has broad authority to enforce compliance with these obligations and to ensure banks operate in a safe and sound manner.

When the agency began discussing national bank charters for eligible fintech companies a few years ago, the focus was primarily, but not exclusively, on chartering national banks that would be engaged in lending activities and would not take deposits. That reflected interest from the industry at the time. The OCC's current focus, as directed by the Acting Comptroller, has been on ensuring that the OCC has an appropriate framework in place to supervise banks that will be engaged in payments services, including those that will not take deposits. To that end, a cross functional team of OCC staff reviewed all facets of the OCC's supervisory framework to validate that we are, in fact, ready and able to effectively supervise payments companies seeking to become national banks. After a fulsome review, the team concluded, with minor tailoring, that the OCC's supervisory framework is more than capable of supervising new companies focused on payments activities. As with all of our institutions, our supervision will be tailored to the risks and business model of the particular institution.

Chartering companies engaged in payments is not new. National banks have been engaged in payments since the creation of the federal banking system. And a decade ago, almost all payments processing occurred with banks and their service providers. But today, an increasing amount of the core banking activity of payments, particularly in the retail space, is migrating to payments companies that compete against traditional banks.

Providing a path for these companies to conduct these activities within the banking system and to supervise it within that system ensures a level, competitive playing field, protects consumers, promotes safety and soundness, and provides regulators a more comprehensive view of financial system activity.

19. Vice Chair Quarles and Acting Comptroller Brooks, with respect to the proposed merger of PNC Financial Services and BBVA USA, given this merger would create the fifth largest U.S. bank with more than $500 billion in consolidated assets, will your agencies be holding public hearings to ensure affected employees, consumers, communities and other stakeholders have a full opportunity to be heard on the proposed merger? In reviewing the proposed merger, will your agencies consult with the Treasury Secretary, in their role as the Chair of the Financial Stability Oversight Council, considering the impact the merger may have on systemic risk? Also, will your agencies consult with the Consumer Financial Protection Bureau considering potential impacts the merger may have on consumers? Will you evaluate whether the proposed merger of the banks makes diversity and inclusion an intentional priority?

Response: The OCC has not yet received an application for the proposed merger of PNC Bank, N.A. and BBVA USA. Once an application is received, the OCC will follow its established licensing processes. The Bank Merger Act (BMA) requires the OCC to consider "the risk to the stability of the United States banking or financial system" when reviewing transactions subject to the BMA. In evaluating a BMA application, the OCC considers whether the proposed transaction would result in a material increase in risks to financial system stability due to an increase in size of the combining institutions. The OCC also considers any other factors that could indicate that the transaction poses a risk to the U.S. banking or financial system. Further, all interstate combinations evaluated by the OCC under the BMA are subject to review for compliance with the Community Reinvestment Act and other applicable statutes. Finally, the OCC generally grants a hearing request if the agency determines that written submissions would be insufficient, a hearing would otherwise benefit the decision-making process, or a hearing would be in the public interest.

**Rep. Rose**

**<u>Question 1</u>**

Nearly 60 percent of ATMs in the United States are independent, nonbank terminals. It is those ATMs that are typically found in low-income communities; and thinly populated rural areas, in which there are few, if any, bank offices or bank-owned ATMs. The widespread closures and denials of bank accounts to businesses within the independent, nonbank ATM industry present a serious threat to the financial stability not only of consumers who live in the areas served almost exclusively by independent, nonbank ATMs, but also the tens of thousands of retail and service businesses serving these consumers daily.

In a Financial Services hearing on February 15, 2018, National ATM Council's (NAC) Tim Baxter testified that the quote "widespread and severe consequences that in recent years have resulted from financial institutions' practice of 'de-risking'" end quote and the prejudicial treatment that was a direct result of federal regulators' implementation of Operation Choke Point in 2013. He noted that it is impossible for ATM operators to do business without having a bank account, but even with the end of the Operation Choke Point initiative, independent ATM providers were increasingly being "notified by their banks, without explanation, that their deposit accounts [were] to be closed, or, in some cases, already [had] been closed."

Question: Could you describe what the regulators are doing to address the fallout from Operation Chokepoint and its effect on ATM owners and operators who are still having their accounts closed? I just sent you a letter asking that you address this issue by doing two things:

1. First, revise and correct misleading or incomplete terminology and statements in the Federal Financial Institutions Examination Council (FFIEC) BSA/AML Examination Manual, which may contribute to a misunderstanding of the independent, non-bank ATM industry.

Response: The FFIEC BSA/AML Examination Manual provides guidance to examiners for carrying out BSA/AML and Office of Foreign Assets Control examinations. OCC staff, along with representatives of the other FFIEC members, are working to issue updates of the manual, and are issuing revised sections in phases. We met with representatives of the independent, nonbank ATM industry earlier this year and are considering the revisions the industry's representatives offered in updating the manual.

2. And second, to provide written guidance to agency field staff and examiners, and to regulated financial institutions, that an independent, non-bank ATM operator that conducts its operations in accordance with industry standards, provides relevant information about its business to its banker(s), and otherwise cooperates with reasonable due diligence conducted by its depository banks ordinarily should not be considered an undue risk.

Response: The OCC's mission is to ensure the banks we supervise operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable law and regulations. We take all aspects of our mission seriously. The OCC expects banks to identify and assess risk within their institution, including individual customer risk, and to design and implement an effective BSA/AML compliance program to manage those risks. Decisions on whom to provide financial services to and how to risk rate customers are generally business decisions and a matter of banker judgement based on numerous factors such as its business objectives, identified product or customer risk, the bank's ability to mitigate those risks, and the bank's risk appetite, profitability, among others. Because each bank's situation is unique, these are not decisions that the OCC typically makes for banks.

The OCC has made a concerted effort to consistently communicate our position on acceptable risk management practices and supervisory expectations to the banking industry, through a variety of formats including public statements and bulletins on the OCC website. Most recently, the OCC along with the other Federal Banking Agencies issued in July 2019 a Joint Statement on Risk-Focused BSA/AML Supervision which reiterates this position.

In furtherance of the OCC's mission, the agency also issued last month a notice of proposed rulemaking on requiring fair access to banking services provided by large national banks, federal savings associations and federal branches and agencies of foreign banking organizations. The proposal would prevent banks with assets over $100 billion —alone or in coordination with others—from limiting fair access to banking services by preventing a business or person from entering, or limiting their ability to enter, a particular market, or disadvantaging a person to benefit another person or interest.

**Question 2**

S.2155 was passed by Congress in 2018 and made great strides to tailor regulations to take into account a financial institution's size and business model. Question: In your view, does tailoring regulations support communities served by small and midsized banks and credit unions while ensuring safety and soundness at those institutions? What more can Congress do to encourage this trend?

Response: Following the passage of S. 2155, the OCC worked with the FDIC and FRB to better tailor the prudential regulations applied to financial institutions of varying sizes and levels of complexity. For community and regional banks, the agencies completed a rulemaking that simplified the capital rules applicable to banks with less than $250 billion in total assets and revised the definition of high volatility commercial real estate exposure consistent with the requirements of section 214 of the Growth Act. The agencies also implemented the Community Bank Leverage Ratio (CBLR) rule, which allows banks with $10 billion or less in total assets to completely forgo the complex calculations required by the risk-based capital rules if they maintain a relatively high leverage ratio. More recently, the agencies revised the CBLR rule to provide further relief by temporarily lowering the minimum leverage ratio requirement. This will allow banks that use the CBLR to continue using it even if they suffer moderate losses during this period of economic uncertainty.

With these changes, we believe that the current standards appropriately ensure the safety and soundness of our banking system while permitting for a strong and robust economy. The overall capital position at large and small banks strengthened considerably in the years leading up to the most recent period of economic instability, and we believe that has helped banks to remain resilient.

The aforementioned requirements ensure that each bank's level of capital is sufficient to assure public confidence in the stability of the bank and the commercial banking system, support the types of business conducted by the bank, provide for the possibility of loss, and permit a bank to meet the credit needs of its community. As a banking regulator, we continually strive to maintain a balance between a sound, well-capitalized banking system and an efficient economy where credit is readily available. To this end, the OCC is committed to continue tailoring regulatory requirements to remove unnecessary burden and increase bank lending and investment in the businesses and communities the banks serve.

**Questions from Representative Anthony Gonzalez**

Comptroller Brooks, in your September 25 statement on FSOC's review of secondary mortgage market issues, you said that the OCC would look at ways to provide appropriate capital relief for CRT transactions in the banking sector. Could you provide more information on the types of review or steps you are considering?

Response: Under the agencies' current capital rule, credit risk transfer (CRT) transactions in which reference assets are sold to a third party qualify for risk-based capital relief if certain conditions are met. In some instances, particularly where assets remain on a bank's balance sheet under U.S. GAAP, the current regulations can result in no capital relief, even though some credit risk is effectively transferred. The agencies have considered a notice of proposed rulemaking (NPR) that would broaden the instances when CRT transactions could result in risk-based capital relief and provide additional pathways for banks to transfer credit risk to private mortgage investors.

For the OCC, Federal Reserve, FDIC: What is your view of the benefits of Fannie Mae and Freddie Mac's use of credit risk transfer as a way of attracting loss absorbing capital for mortgage credit risk?

Response: GSE transactions that effectively transfer credit risk to private markets can reduce systemic risk in housing finance markets, help the GSEs to prudently manage the amount of credit risk they retain, and attract additional private capital into the mortgage market. The OCC supports these objectives.

**<u>Questions from Representative Emmer</u>**

**Foreign Ownership of Payments Charter Recipients**

How would the OCC handle an application for a payments charter from a foreign company? How about a U.S. company that is owned by a foreign company? There is concern that the OCC's proposed payment charter could provide foreign companies with access to the U.S. financial system while allowing them to avoid important systemic safeguards, such as oversight by the Federal Reserve. How is the OCC addressing those issues?

Response: It is permissible for a foreign company to own an uninsured national bank and not be a registered bank holding company. In evaluating a charter proposal for such a bank, the OCC will follow its normal licensing processes, which for new charters includes an evaluation of organizers' familiarity with national banking laws and regulations, competency of management, and capital sufficiency, among other factors. The OCC also considers compliance under the Bank Secrecy Act, anti-money laundering regulations, and economic sanction laws administered by the U.S. Department of the Treasury's Office of Foreign Assets Control. As appropriate, the OCC will impose enforceable conditions or take other supervisory action to address any concerns identified during the licensing process or ongoing supervision, including any concerns related to OCC access to books and records and the enforceability of U.S. banking laws on a foreign owner.

**Mixing of Commercial and Financial Data (Payments Charter)**

Another concern with the OCC's proposed payments charter is the potential mixing of consumer financial data with other consumer data possessed by large commercial companies. If a commercial firm is granted a payments charter and, therefore, access to consumer financial information, how does the OCC feel about the risks posed to consumers by that kind of data consolidation? What specific safeguards would the OCC impose on these companies to prevent them from mixing data in this way?

Response: The OCC is confident in its ability to supervise and enforce for compliance with all applicable information security and consumer protection legal requirements by payments-focused and other OCC-chartered banks. Applicable requirements may include those under the Gramm-Leach-Bliley Act, the Fair Credit Reporting Act, and other laws governing the proper treatment, collection, access, disposal, and security of consumer data and addressing consumer protection. Beyond legal requirements, the OCC has issued public guidance on information security elements of proper third-party and other risk management practices.

The specific safeguards that may be applicable will depend on the facts and circumstances relevant to a given OCC charter applicant, and the OCC will discuss these safeguards with applicants, as appropriate.

**United States House Committee on Financial Services**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions During the Pandemic"**
**Thursday, November 12, 2020**

**Responses to the Questions for the Record**

**Questions for The Honorable Rodney E. Hood, Chairman, National Credit Union Administration, from Chairwoman Maxine Waters:**

*Mortgage Forbearance*

*5) For all four witnesses, Section 4013 of the CARES Act requires federal depository regulators to allow lenders to suspend certain accounting requirements related to loan modifications and troubled debt restructurings (TDRs), and Section 4022 of the CARES Act establishes consumer rights to be granted forbearance for federally insured mortgages. The TDR provision will soon expire, but the pandemic continues to inflict considerable damage to our economy on top of the lives that have been lost. One of the bills we are considering today, the Protecting Consumers and Small Businesses through Forbearance Act, would extend the TDR provision under the CARES Act through next June while also requiring these institutions to provide forbearance and loan modifications to consumers and small business owners. What are your agencies doing to encourage banks and credit unions to do all they can to help consumers and small business owners that need forbearance on their obligations?*

***Response:***

The NCUA has a long-standing supervisory practice of encouraging credit unions to work constructively with borrowers who experience financial hardship. The NCUA has encouraged credit unions to make loan modifications to help those who have been impacted by the COVID-19 pandemic. NCUA examiners will not criticize a credit union's efforts to provide prudent relief for borrowers when such efforts are conducted in a reasonable manner with proper controls and management oversight. Since the pandemic started, the NCUA has repeated this message in letters to credit unions, statements, and on our dedicated COVID-19 website.

The NCUA has also worked hard to ensure that we remove any regulatory hurdles that would prevent credit unions from serving their member-owners. The NCUA wants credit unions to focus on serving their member-owners during the pandemic.

*Asset Thresholds and Participation in the PPP*

*6) For all four witnesses, some depository institutions have expressed concern that their* *participation in the Paycheck Protection Program (PPP) will temporarily push them over regulatory asset thresholds, subjecting them to additional regulation until those loans are forgiven by the Small Business Administration (SBA). Do you share these concerns?*

***Response:***

Per the Coronavirus Aid, Relief, and Economic Security (CARES) Act, all Paycheck Protection Program (PPP) loans are assigned a zero-percent risk weight for risk-based net worth purposes. Due to the work of the NCUA Board to clarify this for credit unions (detailed in my response to question 6a), this has not been an issue for credit unions.

*6a.) The Committee considered two bills that attempt to address this concern as part of this hearing. The first is the Asset Calculation Flexibility to Support Small Businesses Act, which would exempt PPP loans from these calculations through next March, with the intention to allow forgiven PPP loans to roll off a bank's balance sheet while not exempting PPP loans that are not forgiven and will need to be repaid over the next 2 to 5 years. The other is H.R. 8675, the Preventing Regulatory Penalties for PPP Lenders Act, which would exempt all PPP loans, regardless if they are forgiven or not, and limits the application to institutions with less than $15 billion in total assets. Do you have the authority to exempt PPP loans from total assets for the purposes of regulatory thresholds, or would that authority have to be granted in new legislation?*

***Response:***

Per the CARES Act, all PPP loans are assigned a zero-percent risk weight for risk-based net worth purposes.

In April 2020, the NCUA Board approved an interim final rule that amended the NCUA's capital adequacy (NCUA regulation part 702, Capital Adequacy) and member business loans and commercial lending (NCUA regulation part 723, Member Business Loans; Commercial Lending) regulations following the creation of the SBA's Paycheck Protection Program. Under the interim final rule, the NCUA's capital adequacy regulation was amended to assign covered PPP loans a zero-percent risk weight in the agency's risk-based net worth requirements.

In addition, for the purposes of calculating a federally insured credit union (FICU)'s net worth ratio, a PPP loan pledged as collateral for a non-recourse loan provided through the Federal Reserve System's PPP Lending Facility can be excluded from the FICU's calculation of total assets.

By statute, the NCUA is required to assess Share Insurance Fund premiums based on a credit union's insured shares, not total assets. For this reason, there are several key regulatory measures that are not impacted by PPP loans, such as premiums or capitalization. The NCUA continues to review data on the volume of PPP loans and the effect they are having on balance sheets of credit unions and asset growth. With this information, the NCUA Board will be able to consider the effectiveness of regulatory relief measures.

*Supporting Minority Communities*

*7) For all four witnesses, several studies have shown that communities of color are disproportionately affected physically and economically by the COVID-19 pandemic. According to a Federal Reserve Bank of New York report, Black businesses experienced the most acute decline, with a 41 percent drop. Latinx business owners fell by 32 percent and Asian business owners dropped by 26 percent. In contrast, the number of white business owners fell by 17 percent. What has your agency done to mitigate the impact of the pandemic for your minority workforce? What has the agency done to support minority communities economically during this pandemic?*

***Response:***

One of my top priorities at the NCUA is that of advancing diversity and inclusion—it is the civil rights issue of the 21st century. I firmly believe that diversity and inclusion drive success and help achieve the NCUA's core mission. The NCUA's 2018-2022 Diversity and Inclusion Strategic Plan prioritizes diversity and inclusion as a strategic business imperative.

In 2019, the NCUA hosted its first annual Diversity, Equity and Inclusion Summit, a first-of-its-kind event for the industry. In October 2020, the NCUA launched a new initiative called ACCESS, or Advancing Communities through Credit, Education, Stability & Support. Comprised of representatives from across the agency, this initiative will refresh and modernize regulations, policies, and programs that support financial inclusion within the agency and, more broadly, throughout the credit union system. By dedicating resources from across its business units, the NCUA will work to ensure an inclusive and open-minded approach to making access to safe and affordable financial services more widely available.

The NCUA also conducted recent webinars supporting diversity and inclusion. For example, it hosted a financial inclusion webinar in March, 2020 titled "Financial Inclusion: Pathways to Serving the Underserved," and a webinar in October of that year titled "Pathways to Consumer Financial Well-Being: The Importance of Financial Inclusion and Minority Depository Institutions." While these are positive steps, much more must be done if the industry is going to make real progress on these issues.

*Efforts to Promote Diversity within the Prudential Regulators*

*12) For all four witnesses, the Rooney Rule is a policy that originates from the National Football League, where at least one minority and/or woman must be considered for each open leadership position. This Committee recently passed legislation, H.R. 281, Ensuring Diverse Leadership Act sponsored by Rep. Beatty, that would require the consideration of at least one person reflective of both gender and racial or ethnic diversity when filling Federal Reserve Bank president vacancies.[1] At the hearing, we also considered two other pieces of legislation – the Federal Reserve Bank Board Diversity Act and the Diversity in Financial Regulatory Advisory*

[1] https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=404291#:~:text=a%20voice%20vote.-,H.R.,bill%20was%20introduced%20by%20Rep

*Committees Act – that would require consideration of at least one candidate that reflects gender diversity and one candidate that reflect racial diversity for Federal Reserve Bank boards of directors, as well as advisory committees for certain financial agencies. How could a Rooney Rule-like requirement to mandate the consideration of diverse candidates for senior staff roles improve diversity results in your agencies? How have you worked with your respective directors of the Office of Minority and Women Inclusion to increase the representation of women and minorities at all levels of your agency?*

***Response:***

Yes, I work with NCUA Directors, and especially the Director of the NCUA Office of Minority and Women Inclusion to increase the representation of women and minorities at the agency. Progress is being made; for instance, minorities in the NCUA's senior staff ranks increased by four percent to 26.0 percent through Q2 2020, compared to 22.0 percent in Q2 2019.

As for your question about a Rooney Rule-like requirement, without implementing such a rule, the NCUA cannot assess such a rule's impact on diversity results. Current laws and regulations prohibit the NCUA from mandating this requirement, as NCUA senior staff positions are in the competitive service and are thus subject to merit system principles (5 USC § 2301), veterans' preference, and competitive employment practices, as defined by 5 CFR 300 – Subpart A – Employment Practices. Competitive service selection procedures must also meet the standards established by the Uniform Guidelines for Employee Selection Procedures. Of further note, granting any preference or advantage not authorized by law would be a prohibited personnel practice (5 USC § 2302(b)) and would be considered an unlawful employment practice as defined by 42 USC § 2000e-2.

*Market Concentration and Mergers*

*21) Chairman Hood, the NCUA issued a proposed rule expanding the set of credit unions that would be allowed to issue subordinated debt. Banks have raised concerns that allowing credit unions to fund themselves with subordinated debt is inappropriate given their tax-exempt status and could be used to acquire banks. Do you share these concerns? Why or why not?*

***Response:***

I do not share these concerns and consider the proposal to be appropriate and potentially helpful to credit unions working to best serve their member-owners during very difficult times. Under statutory authority, federal credit unions may borrow in the form of subordinated debt. Last January, the NCUA issued a proposed rulemaking that would permit low-income credit unions as well as complex credit unions (that are not low-income) to count qualifying subordinated debt to meet certain capital requirements. The proposed rule also would enable newly chartered credit unions to use subordinated debt to augment their capital and assist the success of their startup phase.

The proposed rule would streamline existing parts to better organize certain NCUA regulations, improve clarity and transparency, and incorporate enhanced investor protections. The rule would also amend parts of the NCUA's regulations to update the authority of low-income credit unions to issue subordinated debt.

This proposed expanded authority has the current potential to provide up to 284 credit unions with greater flexibility to augment their capital planning strategies and support their operations by permitting subordinated debt as an additional funding source.

**FDIC**
**Federal Deposit Insurance Corporation**
550 17th Street NW, Washington, D.C. 20429-9990
Office of the Chairman

January 15, 2021

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

Dear Chairwoman Waters:

Thank you for the opportunity to appear before the Committee on Financial Services on November 12, 2020, at the hearing entitled, "*Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic.*"

Enclosed are the agency's responses to questions submitted for the hearing record. If you have further questions or comments, please do not hesitate to contact me at (202) 898-6868 or Andy Jiminez, Director, Office of Legislative Affairs, at (202) 898-6761.

Sincerely,

Jelena McWilliams

Jelena McWilliams

Enclosure

**Chairwoman Maxine Waters**
**Questions for the Record**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic"**
**Thursday, November 12, 2020**

**Safety and Soundness of Banks During Recession**

1. Vice Chair Quarles and Chairman McWilliams, given the positive correlation between economic downturns and bank failures – including more than 400 failures following the Great Recession – are you expecting an increase in bank failures this time? Is there anything Congress or the bank regulators should do, such as limiting dividend payments, to ensure banks have sufficient capital? For example, the Committee is considering the Promoting Safety and Soundness during the Pandemic Act, which would prohibit global systemically important banks (G-SIBs) from paying dividends during the pandemic. Should prudential regulators promptly implement such an approach on their own?

The FDIC closely monitors the health of the U.S. banking system and publicly reports on these conditions through our *Quarterly Banking Profile*. Consistent with improved economic activity in the third quarter of 2020, the banking industry reported better results relative to the first half of the year.[1] Banks reported higher net income, largely because of lower provisions for credit losses and an increase in noninterest income, compared with the first two quarters of 2020. Lower provisions reflect the improving economy and a general expectation from the banking industry of stabilization in the expected future credit performance of the loan portfolio. Deposit growth stabilized during the third quarter and is now near the average rate of growth between year-end 2014 and year-end 2019. However, economic uncertainty and the low interest rate environment remain headwinds for the banking industry. In the third quarter, banks faced additional downward pressure on net interest margins, an increase in nonperforming loans, and a decline in loan volume. Notwithstanding these challenges, the number of institutions on the FDIC's "Problem Bank List" remained low, increasing to 56 from 52 the previous quarter.

The FDIC has conducted heightened monitoring of financial institutions whose activities or concentrations may present additional concerns due to the economic consequences of the pandemic. We have expanded our regular risk monitoring activities, particularly for institutions that have concentrated exposures to the industries that have been most impacted by the pandemic. Various divisions across the FDIC coordinate to bring together institution-specific and macroeconomic information, including assessments of aggregate banking industry vulnerabilities to credit and liquidity risk. The FDIC will continue to monitor conditions at insured depository institutions for any additional stress or deterioration in asset quality related to the pandemic.

The FDIC also ensures that banks operate with sufficient capital through the supervisory process.

[1] *See* FDIC-Insured Institutions Reported Improved Profitability in Third Quarter 2020 (Dec. 1, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20131.html.

Under applicable law, an insured depository institution is prohibited from making a capital distribution if, after making the distribution, the institution would be undercapitalized.[2] Institutions that are rated 4 or 5 under the Uniform Financial Institutions Rating System, commonly known as CAMELS ratings, are regularly placed under formal enforcement actions that have capital provisions requiring a specific capital level, growth limitations, and/or dividend limitations. When a downgrade to 4 or 5 is expected, but still being processed, supervisory letters are sent to institutions informing them not to pay dividends without prior notice to the FDIC. In addition, all depository institutions regardless of rating are required to maintain a capital conservation buffer in order to avoid restrictions on capital distributions and other payments. The types of payments subject to the capital conservation buffer restrictions include dividends, share buybacks, discretionary payments on tier 1 instruments, and discretionary bonus payments.

4. Vice Chair Quarles, Comptroller Brooks, and Chairman McWilliams, last month, the Fed, OCC, and FDIC finalized an important liquidity rule in response to the 2008 financial crisis – specifically, the Net Stable Funding Ratio (NSFR). The Net Stable Funding Ratio – which requires large banks to have a minimum amount of stable funding backing their assets over a one-year horizon – was proposed to strengthen liquidity requirements for large banks. However, compared to its initial proposal, the final rule would apply the full NSFR to only nine banking organizations compared to 21 banks, completely ignoring the collective financial stability risks of large regional banks. Why was the final NSFR rule narrowed to exempt a number of large banks that individually and collectively pose systemic risks?

Strong capital liquidity requirements for the largest, most systemically important banks are a key pillar of the post-crisis regulatory framework, and our framework continues to apply the most rigorous capital and liquidity standards to the largest banks[3] while also tailoring such standards for banks based on their size, risk profile, and systemic footprint. In 2014, the FDIC, the Federal Reserve Board, and the Office of the Comptroller of the Currency finalized the Liquidity Coverage Ratio (LCR), the first quantitative liquidity standard for U.S. banks.[4] The LCR requires the largest banks to maintain sufficient high-quality liquid assets to meet their total net cash outflows over a 30-day period.

In October 2020, we issued a final rule to implement the Net Stable Funding Ratio (NSFR), which complements the LCR by establishing a long-term quantitative liquidity metric.[5] The NSFR will require covered banks to maintain stable funding to support their assets,

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[2] *See* 12 U.S.C. § 1831o.
[3] These standards include the total risk-based capital ratio, tier 1 risk-based capital ratio, common equity tier 1 risk-based capital ratio, tier 1 leverage ratio, and capital conservation buffer, in addition to supervisory stress testing. Larger banks are also subject to the countercyclical capital buffer, supplementary leverage ratio, enhanced supplementary leverage ratio, capital surcharge for systemically important banks, and total loss-absorbing capacity requirements, among other heightened standards.
[4] *See* Liquidity Coverage Ratio: Liquidity Risk Measurement Standards, 79 Fed. Reg. 61440 (Oct. 10, 2014), available at https://www.govinfo.gov/content/pkg/FR-2014-10-10/pdf/2014-22520.pdf.
[5] *See* Agencies Issue Final Rule to Strengthen Resilience of Large Banks (Oct. 20, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20116.html.

commitments, and derivatives exposures over a one-year time horizon. Consistent with the agencies' tailoring rule,[6] the NSFR requirements will be based on a bank's size, risk profile, and systemic footprint. Category I and Category II institutions will be subject to the full NSFR (*i.e.*, 100%), as would Category III institutions with more than $75 billion in average weighted short-term wholesale funding. Other Category III institutions would be subject to an 85% NSFR, and Category IV institutions with more than $50 billion in average short-term wholesale funding would be subject to a 70% NSFR. In addition, insured depository institution subsidiaries of Category I, II, and III institutions would be subject to the same NSFR requirement as their top-tier holding company if the IDI has more than $10 billion in total assets.

**<u>Mortgage Forbearance</u>**

5. For all four witnesses, Section 4013 of the CARES Act requires federal depository regulators to allow lenders to suspend certain accounting requirements related to loan modifications and troubled debt restructurings (TDRs), and Section 4022 of the CARES Act establishes consumer rights to be granted forbearance for federally insured mortgages. The TDR provision will soon expire, but the pandemic continues to inflict considerable damage to our economy on top of the lives that have been lost. One of the bills we are considering today, the Protecting Consumers and Small Businesses through Forbearance Act, would extend the TDR provision under the CARES Act through next June while also requiring these institutions to provide forbearance and loan modifications to consumers and small business owners. What are your agencies doing to encourage banks and credit unions to do all they can to help consumers and small business owners that need forbearance on their obligations?

On March 13, 2020, the FDIC issued a statement encouraging institutions to assist consumers and communities affected by COVID-19.[7] In that statement, we encouraged financial institutions to work with all borrowers, especially borrowers from industry sectors particularly vulnerable to economic volatility, including airlines; energy companies; travel, tourism, and shipping companies; small businesses; and independent contractors that are reliant on affected industries. The statement also provided that prudent efforts to modify the terms on existing loans for affected customers of FDIC-supervised banks will not be subject to examiner criticism. Later in March 2020, the FDIC and our fellow regulators provided needed flexibility for banks to work with their borrowers and modify loans when appropriate.[8] We confirmed with the staff of the Financial Accounting Standards Board (FASB) that short-term modifications (e.g., six months) made on a good faith basis in response to COVID-19 to borrowers who were current prior to any relief are not troubled debt restructurings (TDRs) under ASC Subtopic 310-40.

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[6] *See* Changes to Applicability Thresholds for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.

[7] *See* FDIC, FIL-17-2020, *Regulatory Relief: Working with Customers Affected by the Coronavirus* (Mar. 13, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20017.html.

[8] *See* FDIC, FIL-36-2020, *Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus* (Apr. 7, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20036.html; *see also* FDIC-FIL-22-2020, *Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus* (Mar. 22, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html.

Additionally, under Section 4013 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), loan modifications related to COVID-19, executed on loans that were not more than 30 days past due as of December 31, 2019 and executed prior to December 31, 2020, do not need to be categorized as TDRs. The TDR treatment provided in Section 4013 of the CARES Act was recently extended by Congress until January 1, 2022. As a result, any loan modifications eligible under Section 4013 of the CARES Act will not need to be considered TDRs for the duration of 2021.

The FDIC also issued responses to frequently asked questions (FAQs) from financial institutions, which encourage institutions to offer borrowers affected by COVID-19 payment accommodations, such as allowing borrowers to defer or skip payments or extending the payment due date.[9] The FAQs also state that financial institutions can call their FDIC Regional Office, which can assist them by discussing key considerations and regulations on payment accommodations and disclosures.

**Asset Thresholds and Participation in the PPP**

6. For all four witnesses, some depository institutions have expressed concern that their participation in the Paycheck Protection Program (PPP) will temporarily push them over regulatory asset thresholds, subjecting them to additional regulation until those loans are forgiven by the Small Business Administration (SBA). Do you share these concerns?

    a. The Committee considered two bills that attempt to address this concern as part of this hearing. The first is the Asset Calculation Flexibility to Support Small Businesses Act, which would exempt PPP loans from these calculations through next March, with the intention to allow forgiven PPP loans to roll off a bank's balance sheet while not exempting PPP loans that are not forgiven and will need to be repaid over the next 2 to 5 years. The other is H.R. 8675, the Preventing Regulatory Penalties for PPP Lenders Act, which would exempt all PPP loans, regardless if they are forgiven or not, and limits the application to institutions with less than $15 billion in total assets. Do you have the authority to exempt PPP loans from total assets for the purposes of regulatory thresholds, or would that authority have to be granted in new legislation?

Since the beginning of the COVID-19 pandemic, the FDIC has taken a number of actions to show flexibility in its regulatory approach in response to the unprecedented economic conditions and unique government response,[10] which resulted in record deposit inflows at FDIC-insured banks. Banks experienced two consecutive quarters of over $1 trillion in new deposits, increases

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[9] *See* FDIC, *Frequently Asked Questions for Financial Institutions Affected by the Coronavirus Disease 2019 (Referred to as COVID-19)*, available at https://www.fdic.gov/coronavirus/faq-fi.pdf.

[10] For a detailed description of these actions, see FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (May 12, 2020), available at https://www.fdic.gov/news/speeches/spmay1220.html and FDIC Chairman Jelena McWilliams, "Oversight of Financial Regulators," testimony before S. Comm. on Banking, Hous., and Urban Affairs (Nov. 10, 2020), available at https://www.fdic.gov/news/speeches/spnov1020.html.

that far exceed any deposit growth the FDIC has seen in the past. In October 2020, we issued an interim final rule to allow insured depository institutions (IDIs) that have experienced growth to determine whether they are subject to the requirements of Part 363 of the FDIC's regulations (*i.e.*, Annual Independent Audits and Reporting Requirements) for fiscal years ending in 2021 based on their consolidated assets as of December 31, 2019.[11]

Consistent with that action and the principle of targeted regulatory flexibility, the FDIC joined the Federal Reserve Board and the Office of the Comptroller of the Currency in issuing an interim final rule to similarly "freeze" an IDI's asset size for purposes of determining applicability of certain regulations for community banks.[12] The rule, which applies to certain regulatory thresholds of $10 billion or less, provides that an IDI generally can calculate its asset size for applicable thresholds during calendar years 2020 and 2021 based on the lower of either total assets as of December 31, 2019 or total assets as of the normal measurement date. Through its application to thresholds under the community bank leverage ratio, management interlocks, Call Reports, and examination frequency rules, the rule provides community banks with temporary relief from incurring material costs to comply with new regulatory requirements during a time of economic disruption.

**Supporting Minority Communities**

7. For all four witnesses, several studies have shown that communities of color are disproportionately affected physically and economically by the COVID-19 pandemic. According to a Federal Reserve Bank of New York report, Black businesses experienced the most acute decline, with a 41 percent drop. Latinx business owners fell by 32 percent and Asian business owners dropped by 26 percent. In contrast, the number of white business owners fell by 17 percent. What has your agency done to mitigate the impact of the pandemic for your minority workforce? What has the agency done to support minority communities economically during this pandemic?

As the COVID-19 pandemic continues to disrupt the daily lives of all Americans, we are particularly mindful that minority and low- and moderate-income communities have suffered disproportionately, both from a health and economic perspective. Shaped by my personal experiences and guided by a commitment to increasing financial inclusion in traditionally underserved communities, one of my priorities as FDIC Chairman has been expanding our engagement in support of minority depository institutions (MDIs). An MDI is often the financial lifeblood of the community it serves, enabling individuals and minority-owned small businesses to securely build savings and obtain credit. We have embraced our statutory responsibility to promote and preserve the health of MDIs by seeking new and innovative ways to engage with these institutions and better understand their needs. For example, the FDIC is facilitating the creation of a Mission-Driven Bank Fund that will provide opportunities for MDIs to propose

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[11] *See* Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021, 85 Fed. Reg. 67427 (Oct. 23, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-10-23/pdf/2020-23630.pdf.

[12] *See* Temporary Asset Thresholds, 85 Fed. Reg. 77345 (Dec. 2, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-12-02/pdf/2020-26138.pdf.

investments in equity capital, loan participations, and other mechanisms to build capacity and scale.[13] With significant investment commitments by private companies, philanthropic organizations, and other financial institutions, we believe this fund will provide a sizeable source of capital and other helpful tools that can help MDIs grow their operations and expand their impact in minority communities.

The FDIC also remains deeply committed to fostering a diverse workforce and inclusive work environment. We have adopted a number of strategies that help all employees in our workforce to mitigate the impact of COVID-19, especially minorities, those who are caregivers, and those who are parents of pre-school or school-aged children. We have bolstered awareness of our Worklife Program, which provides resources and services to support our employees' unique work and personal needs: financial, legal, dependent/elder care, health coaching, onsite clinical counselors, and other support services. As part of our career development program, we have also increased diversity and inclusion training for all employees, including those engaged in the recruiting and hiring process; expanded voluntary educational opportunities; increased remote training and learning opportunities to expand access and minimize travel; and increased engagement by senior leadership with all nine of our Employee Resource Groups. To enhance our diversity and inclusion efforts, we have engaged an independent consultant to identify any remaining barriers that may exist for career advancement by women or minorities to the most senior levels of the agency and for persons with disabilities to effectively participate in the hiring process.

To assist our managers in leading across differences – whether cultural, racial, gender, or based on disability status – we also have engaged the independent consultant to provide a Diversity, Equity, and Inclusion (DEI) "Help Desk." The DEI Help Desk is intended to be an on-demand "ask an expert" resource to help as managers navigate through DEI issues in the workplace. The Help Desk is available to be used by managers to gain a greater understanding of how to better handle a variety of DEI circumstances, including situations where minority, women, caregivers, and parents in the workforce are being impacted by the pandemic.

**<u>Efforts to Promote Diversity within the Prudential Regulators</u>**

12. For all four witnesses, the Rooney Rule is a policy that originates from the National Football League, where at least one minority and/or woman must be considered for each open leadership position. This Committee recently passed legislation, H.R. 281, Ensuring Diverse Leadership Act sponsored by Rep. Beatty, that would require the consideration of at least one person reflective of both gender and racial or ethnic diversity when filling Federal Reserve Bank president vacancies.[14] At the hearing, we also considered two other pieces of legislation – the Federal Reserve Bank Board Diversity Act and the Diversity in Financial Regulatory Advisory Committees Act – that would require consideration of at least one candidate that reflects gender diversity

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[13] *See* FDIC, The Mission-Driven Bank Fund, available at https://www.fdic.gov/regulations/resources/minority/mission-driven/infographic.pdf.

[14] https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=404291#:~:text=a%20voice%20vote.-,H.R.,bill%20was%20introduced%20by%20Rep.

> and one candidate that reflect racial diversity for Federal Reserve Bank boards of directors, as well as advisory committees for certain financial agencies. How could a Rooney Rule-like requirement to mandate the consideration of diverse candidates for senior staff roles improve diversity results in your agencies? How have you worked with your respective directors of the Office of Minority and Women Inclusion to increase the representation of women and minorities at all levels of your agency?

The diversity of the FDIC workforce has increased across most categories during my tenure. As of November 30, 2020, minorities represented over 31 percent of the permanent workforce and women accounted for approximately 45 percent. The FDIC has also increased diversity across our leadership: minorities hold 23 percent of the management-level positions at the FDIC, and women hold 40 percent (up from almost 16 percent and 30 percent, respectively, ten years ago).[15] Likewise, my senior leadership team comprises a diverse set of individuals (38 percent women and 29 percent minorities).[16]

I have worked to elevate the role of OMWI and cultivate a culture of excellence to further implement meaningful change. Working with our OMWI Director, I have proposed several additional actions to increase diversity and inclusion at the FDIC.[17] FDIC senior leaders routinely work with our OMWI Director on numerous issues related to diversity and inclusion at the FDIC, in our business operations, across the financial sector, and in support of financial inclusion initiatives. In 2021, the FDIC will announce the first corporate performance goal dedicated to improving diversity, equity, and inclusion. A new strategic plan is being finalized that will outline our commitment to make improvements in our workforce, our business activities, and our regulated entities. A new performance standard was recently implemented for managers that focus on employee career development and cultivation of an inclusive, constructive, harassment-free work environment. In addition, senior leaders will develop and implement plans to reduce under representation in their respective areas.
In general, having a more diverse applicant pool is likely to increase workforce diversity. The FDIC actively considers diverse candidates for senior staff roles and has taken several steps to improve results. For example:

- The Chief Human Capital Officer has worked with the OMWI Director to further integrate diversity, equity, and inclusion benchmarks within the executive hiring process to include the assessment process, interview questions, interview panel demographics, interview format, and final selection process.
- The OMWI Director and Human Resources meet with hiring managers to discuss strategies to fill their senior positions.
- The FDIC posts executive vacancies to all sources when appropriate, enabling senior leadership to consider a broader pool of candidates.
- The FDIC publishes all vacancies on a weekly basis to multiple National Affinity Groups,

[15] As of November 30, 2020.
[16] As of November 30, 2020.
[17] For a more detailed description of our work in this area, see Nikita Pearson, Acting Director, Office of Women and Minority Inclusion, Federal Deposit Insurance Corporation, "Holding Financial Regulators Accountable for Diversity and Inclusion: Perspectives from The Offices of Minority and Women Inclusion," testimony before H. Comm. on Fin. Servs. (Sept. 8, 2020), available at https://www.fdic.gov/news/speeches/spsep0820.html.

Veterans Organizations, Federal Executive Boards, State Departments of Vocational Rehabilitation, colleges and universities, and the FDIC-recognized Employee Resource Groups.

- The FDIC recently entered into a contract with an external consulting firm to assist the FDIC to create a new assessment and selection process for our executive positions, which will build on our previous efforts to increase diversity in our most senior positions.
- The FDIC has engaged an external consultant to conduct a barrier analysis. The goal of the barrier analysis is to identify and eliminate, if found, any root causes or disparities in equal employment opportunities at the senior grade level.

On March 5, 2020, I announced a targeted voluntary separation incentive and early retirement program intended to proactively reshape our workforce.[18] The program was intended to facilitate orderly succession management by providing the Agency with an opportunity to accelerate the transition to the new skills, tools, and leadership necessary that will be needed in the future to fulfill the FDIC's mission responsibilities. It would have also created opportunities to further diversity within the workforce, particularly in the leadership ranks. The average tenure of employees at the FDIC is 25 years, and low turnover has challenged the agency's ability to make meaningful changes quickly. Unfortunately, we were forced to suspend this initiative soon after it was announced to allow the agency to assess the economic impact of the pandemic on the banking industry and maintain our readiness to respond to any problems that emerged. We will consider reinstituting this program as we gain greater certainty about these impacts.

**Rent-a-Bank Partnerships that Harms Consumers**

16. Chairman McWilliams, for a few years now, several banks supervised by the FDIC are helping predatory lenders evade state interest rate caps. For example, Finwise Bank in Utah is helping Elevate make Rise installment loans up to 149% APR in numerous states that do not allow that rate. FDIC supervised banks are facilitating high-cost rent-a-bank loans including installment loans, lines of credit, point-of-sale loans, auto title loans, and predatory small business loans that jeopardize not only businesses but homes. What is the FDIC doing to stop this misuse of the bank charter?

In July 2020, the FDIC issued a final rule clarifying the law governing the interest rates state banks may charge,[19] which Congress put in place for FDIC-regulated institutions in 1980.[20] This

[18] *See* FDIC Offers Voluntary Retirement and Early Separation Program (Mar. 5, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20023.html.
[19] *See* Federal Interest Rate Authority, 85 Fed. Reg. 44146 (July 22, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-07-22/pdf/2020-14114.pdf.
[20] *See* Section 2[27(b)] of the Act of September 21, 1950 (Pub. L. No. 81-797), effective September 21, 1950, as added by section 521 of title V of the Act of March 31, 1980 (Pub. L. No. 96--221; 94 Stat. 164), effective March 31, 1980, provides that "[i]n order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on ninety-day commercial paper

provision of the FDI Act had been interpreted in two published opinions by the FDIC's General Counsel in 1998.[21] The rule provides that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act would be determined at the time the loan is made, and interest on a loan permissible under section 27 would not be affected by subsequent events, such as a change in state law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

Section 27 expressly provides states with the authority to opt out of this interest rate regime with respect to loans made in the state. This opt-out authority is exercised by adopting a law, or certifying that the voters of the state have voted in favor of a provision, stating explicitly that the state does not want section 27 to apply with respect to loans made in such state. If a state opts out of section 27, state banks making loans in that state could not charge interest at a rate exceeding the limit set by the state's laws, even if the law of the state where the bank is located would permit a higher rate.

The rule states that the FDIC views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s). Although I am unable to address any confidential supervisory information or provide institution-specific information in this public response, the FDIC will continue to examine supervised institutions for compliance with all applicable laws and regulations to prevent illegal or unlawful behavior.

**Industrial Loan Companies (ILCs) and Fintech Charters**

17. Chairman McWilliams, the FDIC recently granted federal insurance to two fintech companies – Square and Nelnet – seeking ILC charters and issued a proposed rule to codify FDIC policy on regulating ILCs. It has also received an application from Rakuten, a very large Japanese online-retailer and technology company. How does the FDIC's proposed rule with respect to industrial banks[22] promote the separation of banking and commerce? For example, can a new ILC owned by a very large technology company be approved for FDIC-insurance?

On December 15, 2020, the FDIC issued a final rule to formalize our framework for supervising industrial banks.[23] The rule, which is consistent with the FDIC's historical practice regarding the establishment and supervision of industrial banks, implements the law as mandated by Congress. Whether commercial firms should continue to be able to own industrial banks is a policy decision for Congress to make.

Although Federal banking regulation has historically advanced a policy of separating banking

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in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater."

[21] *See* FDIC General Counsel's Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17, 1998); FDIC General Counsel's Opinion No. 11, 63 Fed. Reg. 27282 (May 18, 1998).

[22] FDIC, *FDIC Seeks Comment on Proposal to Ensure Safety and Soundness of Industrial Banks* (Mar. 17, 2020).

[23] *See* FDIC Approves Rule to Ensure Safety and Soundness of Industrial Banks (Dec. 15, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20137.html.

and commerce, there is an express congressional exception of industrial banks from the Bank Holding Company Act's (BHCA) restrictions on commercial affiliations. The exception, adopted as part of the Competitive Equality Banking Act of 1987 (CEBA), which the FDIC has responsibility to implement, does not limit eligible parent companies to those engaged in financial activities.

The concern that commercial ownership of an industrial bank could potentially lead to conflicts of interest in the lending process – a concern that underlies the general prohibition against the mixing of banking and commerce in the BHCA – is mitigated by Sections 23A and 23B of the Federal Reserve Act. Sections 23A and 23B restrict industrial banks from making favorable loans to their affiliates and quantitatively and qualitatively limit transactions between an industrial bank and its affiliates.[24] Furthermore, section 23B of the Federal Reserve Act requires that any transaction between a bank and its affiliates must be "on terms and under circumstances, including credit standards, that are substantially the same, or at least as favorable to [the] bank or its subsidiary as those prevailing at the time for comparable transactions" with unaffiliated companies.[25] All covered transactions between an industrial bank and its affiliates must be on terms and conditions that are consistent with safe and sound banking practices.[26] Most conflict situations affecting banks and their affiliates can be mitigated through the supervisory process and application of the restrictions in sections 23A and 23B and need not pose excessive risk to the bank or the banking system.

The FDIC recognizes the possibility that a large and complex company may seek to acquire an industrial bank as emerging technologies and other trends lead to changes in the provision of banking services. The FDIC would conduct a thorough review of any such proposal, including the proposed business plan, prospective risk profile presented in the business plan, and the proponent's long-term viability.

The FDIC also may evaluate the competitive effects of such a proposal when considering the deposit insurance application, specifically in connection with the statutory factors of the risk to the Deposit Insurance Fund and the convenience and needs of the community to be served, in order to ensure the market for the provision of banking services remains competitive and safe and sound.[27] Moreover, the FDIC must consider the anticompetitive effects of a transaction when it is evaluating a notice under the Change in Bank Control Act or an application under the Bank Merger Act.[28]

Recognizing that the business models proposed by industrial banks are evolving (*e.g.*, the increasing interplay of services between the bank and its nonfinancial affiliates), the FDIC issued the final rule in order to help ensure the safety and soundness of industrial banks. The final rule incorporates lessons learned from the FDIC's supervisory experience with industrial banks to promote enhanced supervision of the bank and parent company and to ensure that the parent company is a source of strength for the bank.

[24] *See* 12 U.S.C. § 371c(a)(1), § 371c-1(a)(1); *see also* 12 U.S.C. § 1828(j).
[25] 12 U.S.C. § 371c-1(b).
[26] *See* 12 U.S.C. § 371c(a)(4).
[27] As part of its considerations, the FDIC may also seek the views of other Federal agencies.
[28] *See* 12 U.S.C. § 1817(j)(7)(A), (B); § 1828(c)(5).

The FDIC Board of Directors approved two deposit insurance applications submitted by Square Financial Services and Nelnet to create *de novo* industrial banks. The FDIC Board determined that the applications satisfied the seven statutory factors under section 6 of the FDI Act, and the Board's approval of deposit insurance for these industrial banks fulfilled the agency's statutory responsibility. As part of both approvals, the FDIC required the industrial banks and their parent companies to enter into Capital and Liquidity Maintenance Agreements and Parent Company Agreements to protect the industrial bank and address potential risks to the Deposit Insurance Fund.

**Market Concentration and Mergers**

23. Vice Chair Quarles and Chairman McWilliams, regarding the proposed purchase of CIT by First Citizens bank – which would create the 19th largest bank in the country with nearly $110 billion in total assets –will you commit to holding public hearings that ensure all affected parties, including community organizations, and current consumers of CIT or First Citizens, are able to share their perspectives, and to help stakeholders better understand the potential impact on local bank branches and their employees? Will your agencies commit to reviewing the community reinvestment and fair housing records and obligations of the merger? Will you consult with the CFPB, HUD, and any other relevant federal agencies to determine the impact on credit access by local consumers and on the availability of consumer choice in the affected areas? Will you evaluate whether the proposed merger of the banks makes diversity and inclusion an intentional priority?

Merger transactions are considered under the framework of the BMA, section 18(c) of the Federal Deposit Insurance Act (FDI Act).[29] In an effort to promote transparency, I have made public the FDIC's Applications Procedures Manual used by staff in evaluating merger applications.[30]

Many of the issues you raise are relevant to the FDIC's consideration of statutory factors under the BMA, which include (1) whether the proposed merger transaction would result in a monopoly; (2) whether the effect of the proposed merger in any section of the country would substantially lessen competition or tend to create a monopoly, or in any other manner restrain trade, unless the responsible agency finds that the anti-competitive effects of the proposed transaction are clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served; (3) the financial and managerial resources and future prospects of the existing and proposed institutions; (4) the convenience and needs of the community to be served; (5) the risk to the stability of the U.S. banking or financial system; (6) the effectiveness of any insured depository institution involved in the transaction in combatting money laundering activities, including in overseas branches; and (7) whether, upon consummation of the transaction, the resulting insured depository institution would control more than 10 percent of the total amount of deposits of insured depository

[29] *See* 12 U.S.C. § 1828(c).
[30] *See* FDIC, Application Procedures Manual, available at https://www.fdic.gov/regulations/applications/resources/apps-proc-manual/section-04-mergers.pdf.

institutions in the United States.[31]

The BMA requires the FDIC to consider how the proposed merger would affect the convenience and needs of the communities to be served by the resulting institution. In so doing, the FDIC fully considers how the proposed merger may affect consumers' access to affordable financial products and services. In addition, as required under the Community Reinvestment Act, the FDIC must fully consider the record of performance of each institution involved in the merger in meeting the credit needs of the entire community, including low- and moderate-income neighborhoods, consistent with the safe and sound operation of the institution. The FDIC also regularly consults with all relevant federal and state regulators, and fully considers the compliance history of the parties to a merger transaction, including with respect to the Equal Credit Opportunity Act and the Fair Housing Act.

The BMA requires that notice of a merger transaction be published in order to afford the public an opportunity to comment on proposal.[32] The FDIC's regulations enable interested parties to request a hearing on a merger application, which the FDIC will generally grant if it determines that written submissions would be insufficient or that a hearing otherwise would be in the public interest.[33]

With respect to diversity and inclusion, I recognize the FDIC's role in promoting a financial system that is inclusive and responsive to the needs and interest of community served by the banks that we supervise. Although the BMA statutory factors do not specifically include a review of a proposed bank's diversity and inclusion efforts, the FDIC considers all representations and commitments made by merger applications, including with respect to their diversity and inclusion efforts, as a part of the application process, particularly to the extent that such information relates to one of the BMA statutory factors. Furthermore, our Division of Consumer Protection carefully considers consumer complaints and scrutinizes proposed banks' potential community impacts and outreach efforts.

**Public Bank Ratings**

24. Chairman McWilliams and Vice Chair Quarles, late last year, the FDIC and Federal Reserve requested public comment on the Uniform Financial Institution Ratings Systems, better known by the CAMELS acronym, that governs how banks are rated by regulators. As the pandemic continues, questions remain about how the related downturn may affect the safety and soundness of banks. Research by the Federal Reserve Bank of Boston suggests that improving disclosure at troubled U.S. banks during a banking crisis would not destabilize the financial system and would provide conditions for market discipline to work more effectively.[34] Furthermore, the Dodd-Frank Act created a new failure resolution framework that regulators and policy makers have expressed great degree of confidence in containing potential contagion from the failure of any single large financial institution. Do

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[31] *See id.*
[32] *See* 12 U.S.C. § 1828(c)(3).
[33] *See* 12 CFR § 303.10.
[34] https://www.bostonfed.org/publications/research-department-working-paper/1999/the-impact-of-greater-bank-disclosure-amidst-a-banking-crisis.aspx

you agree that publicly releasing CAMELS ratings would promote market discipline? Additionally, do you believe it would help serve as deterrent for risky business practices?

In October 2019, the FDIC and the Federal Reserve Board issued a request for information on the consistency of ratings assigned under the Uniform Financial Institutions Rating System, commonly known as CAMELS ratings because of the six evaluation components (i.e., Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk).[35] This system was established in 1979 and updated and expanded in 1996. Despite vast changes in technology, industry practices, and regulatory standards, the system has not been materially updated in approximately 25 years. The request for information sought feedback on how CAMELS ratings are assigned to supervised institutions and the implications of such ratings in the application and enforcement action processes. However, the request for information did not contemplate the public release of CAMELS ratings. While the FDIC prioritizes transparency and has taken many steps to improve transparency in recent years,[36] this goal must be balanced with the importance of preserving the nonpublic nature of confidential supervisory information, including supervisory ratings. FDIC regulations specifically provide that the report of examination and the information contained within the report, including CAMELS ratings, are strictly privileged and confidential.[37] The FDIC prohibits disclosure of such confidential supervisory information in any manner without permission, except in limited circumstances.

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[35] *See* Request for Information on Application of the Uniform Financial Institutions Rating System, 84 Fed. Reg. 58383 (Oct. 31, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-10-31/pdf/2019-23739.pdf.
[36] *See* FDIC, Trust through Transparency, available at https://www.fdic.gov/about/initiatives/trust-through-transparency.
[37] *See* 12 CFR § 309.

**Congressman Anthony Gonzalez**
**Questions for the Record**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic"**
**Thursday, November 12, 2020**

For the OCC, Federal Reserve, FDIC: What is your view of the benefits of Fannie Mae and Freddie Mac's use of credit risk transfer as a way of attracting loss absorbing capital for mortgage credit risk?

Prior to the global financial crisis, Fannie Mae and Freddie Mac (the Enterprises) were two of the largest, most highly leveraged financial companies in the world. Since being placed into conservatorship in September 2008, their role in the mortgage market has only grown. If and when the companies are released from conservatorship, robust capital standards will be critical to help protect the mortgage markets and taxpayers during future housing market downturns. The Federal Housing Finance Agency's recently finalized rule represents a dramatic improvement to the pre-crisis model.[38] The framework establishes risk-based and leverage capital requirements for Fannie Mae and Freddie Mac. Relative to the proposal, the final rule generally increases the dollar amount of the capital relief for certain credit risk transfer structures commonly entered into by the Enterprises. As the rule notes, these changes are intended to better tailor the risk-based capital requirements to the risk retained by an Enterprise on its credit risk transfers.

[38] *See* Enterprise Regulatory Capital Framework, 85 Fed. Reg. 82150 (Dec. 17, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-12-17/pdf/2020-25814.pdf.

**Congressman John Rose**
**Questions for the Record**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic"**
**Thursday, November 12, 2020**

**Chair McWilliams**

S.2155 was passed by Congress in 2018 and made great strides to tailor regulations to take into account a financial institution's size and business model.

> **Question:** In your view, does tailoring regulations support communities served by small and midsized banks and credit unions while ensuring safety and soundness at those institutions? What more can Congress do to encourage this trend?

The appropriate calibration of our regulatory framework remains a top priority for the FDIC, and we have taken a number of actions in furtherance of this goal. Given the wide range of risk profiles across banking organizations, it is critical that regulators continuously evaluate whether our rules are being applied properly and not imposing unnecessary regulatory burdens. Following the enactment of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),[39] which set forth specific legislative instructions for regulatory tailoring, the FDIC, the Federal Reserve Board, and the Office of the Comptroller of the Currency finalized a number of regulatory changes, including a rule that implements a key part of EGRRCPA by establishing four risk-based categories for determining capital and liquidity requirements for larger banks.[40] By applying our regulations based on an institution's specific risk profile, we better support the ability of banks to serve their customers and communities while maintaining safety and soundness across the banking system.

[39] Pub. L. 115-174 (May 24, 2018), available at https://www.govinfo.gov/content/pkg/PLAW-115publ174/pdf/PLAW-115publ174.pdf.
[40] *See* Changes to Applicability Thresholders for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019), available at https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.

**Congressman Roger Williams**
**Questions for the Record**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions during the Pandemic"**
**Thursday, November 12, 2020**

Chairman McWilliams, the COVID-19 pandemic has highlighted the importance of getting the brokered deposits issue solved to ensure that banks are able to partner with third-party service providers and better serve their customers. I have 2 questions that I am hoping to get answered on this issue

1. The intent of the proposed final rules seems to be focus on the active engagement of 3rd parties in opening an account and maintaining some control over those funds after the account is open. If a third party merely assists a bank establish a direct relationship with an individual depositor, that the bank owns and controls, and the third party has no authority to place, manage or controls any depositor funds…would you agree that the 3rd party would not be a deposit broker and the funds that that 3rd party helped the bank attract would not be brokered?

On December 15, 2020, the FDIC approved a final rule that modernizes our brokered deposit regulations.[41] The goals of this rulemaking process were to develop a framework that encourages innovation, minimizes risk to the Deposit Insurance Fund, provides more clarity and consistency in what is and what is not a brokered deposit, and takes a balanced approach to interpreting section 29 of the Federal Deposit Insurance Act (FDI Act) that tracks the letter and spirit of the statute.[42] Modernizing the brokered deposits regulations is intended to reduce regulatory impediments to new ways of delivering banking services to customers, better reflecting how consumers access banking services in 2020 and beyond, while continuing to promote safe and sound practices.

Relative to the proposed rule, the final rule clarifies and narrows the scope of the activities that would cause a third party to meet the "deposit broker" definition by engaging "in the business of placing deposits, or facilitating the placement of deposits, of third parties with insured depository institutions." For example, the final rule does not retain the proposed criteria that a third party meets the "deposit broker" definition by sharing customer information with banks. Instead, the final rule replaces the sharing of customer information activity with a specific matchmaking activity. The FDIC made this change to ensure that the final rule does not have the unintended effect of capturing third parties that do not have influence or control over the depositor.

Moreover, the FDIC recognizes that a number of entities, including some financial technology companies, partner with one insured depository institution to establish exclusive deposit placement arrangements. In an effort to clarify the types of persons that meet the "deposit broker" definition, and consistent with the statute, any person that has an exclusive deposit

[41] *See* FDIC Board Approves Final Rule on Brokered Deposit and Interest Rate Restrictions (Dec. 15, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20136.html.
[42] *See* FDIC Chairman Jelena McWilliams, "Brokered Deposits in the Fintech Age," speech before the Brookings Institution (Dec. 11, 2019), available at https://www.fdic.gov/news/news/speeches/spdec1119.html.

placement arrangement with one insured depository institution, and is not placing or facilitating the placement of deposits at any other insured depository institution, will not meet the "deposit broker" definition.

The final rule also identifies a number of business relationships that automatically meet the "primary purpose exception" to the "deposit broker" definition, and establishes a transparent application process for entities that seek a "primary purpose exception" but do not automatically meet the exception.

2. You have spoken about your support for a simple restriction on asset growth for banks that are in trouble. You have indicated that this would be a far easier regime for the FDIC to administer and would more directly address the key goal of preventing troubled banks from using insured deposits in an unsafe and unsound manner. Do you continue to support a replacement of Section 29 of the FDIA that would focus on rapid asset growth rather than deposit taking?

I continue to support replacing section 29 of the FDI Act with a simple restriction on asset growth for banks that are in trouble.[43] Such a limitation would be more durable and retain its effectiveness as the industry evolves and as banks change the way they attract deposits over time, while still furthering Congress's goal to restrict the ability of banks using federally-insured deposits to grow their way out of trouble. If Congress chooses to tackle these issues, the FDIC stands ready to provide assistance.

[43] *See id*; *see also* Statement by FDIC Chairman Jelena McWilliams on the Combined Final Rule on Brokered Deposits and Interest Rate Restrictions (Dec. 15, 2020), available at https://www.fdic.gov/news/speeches/spdec1520b.html.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

March 31, 2021

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

Dear Madam Chairwoman:

Enclosed are my responses to the questions you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on December 2, 2020.

**Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Chairwoman Waters:**

**1. Safety and Soundness of Banks During Recession**

**Vice Chair Quarles and Chairman McWilliams, given the positive correlation between economic downturns and bank failures – including more than 400 failures following the Great Recession – are you expecting an increase in bank failures this time? Is there anything Congress or the bank regulators should do, such as limiting dividend payments, to ensure banks have sufficient capital? For example, the Committee is considering the Promoting Safety and Soundness during the Pandemic Act, which would prohibit global systemically important banks (G-SIBs) from paying dividends during the pandemic. Should prudential regulators promptly implement such an approach on their own?**

Current regulatory and supervisory frameworks and programs, as expanded and enhanced since the financial crisis, have been effective in promoting a strong capital position for the banking system. U.S. banks entered the current crisis in strong capital positions, and are well positioned to provide loans and other financial services to businesses and households during the recession. Large banks' common equity tier 1 capital ratio increased from 12 percent in the fourth quarter of 2019 to 12.9 percent in the fourth quarter of 2020, despite the amount of loan loss reserves doubling. While the economic outlook still remains uncertain, current indicators of bank capital and liquidity do not point to a material increase in bank failures.

In its annual supervisory stress test released in June 2020, together with related analysis conducted in light of the COVID event, the Federal Reserve Board (Board) found that large banks were sufficiently capitalized. However, given the heightened economic uncertainty, the Board took additional steps to preserve bank capital using the existing regulatory framework, and limited capital distributions among large banks during the second half of 2020.

On March 25, the Board announced that the temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, following completion of the upcoming round of stress tests. Firms with stress tests results reflecting risk-based capital levels above minimum requirements will no longer be subject to the additional restrictions as of June 30. Instead, these firms will be subject to restrictions based on the Board's regular capital framework, the stress capital buffer. Firms with stress tests results reflecting risk-based capital levels below their minimum requirements will remain subject to the restrictions.

As such, the existing regulatory and supervisory regime will continue to promote the banking system's resiliency.

**2. Vice Chair Quarles, in September 2020, the Fed banned stock buybacks and constrained dividend payments by the largest banks to safeguard their solvency against COVID-19 – however, it did not prohibit dividend payments entirely. Given economic activity will likely**

**be constrained until the pandemic is over, why didn't the Fed prohibit dividend payments entirely?**

In June 2020, the Federal Reserve published the results of its normal full stress test, the 2020 Dodd-Frank Act Stress Test, and a sensitivity analysis to assess the resiliency of large banks under three hypothetical downside scenarios that could result from the COVID event and the imposition of associated containment measures.[1] The stress test and sensitivity analysis showed that the system had ample capital to meet even a severe downturn while continuing to make all planned capital distributions. Nevertheless, out of an abundance of caution in light of the COVID event's unprecedented nature, the Federal Reserve suspended share repurchases and limited dividend payments through the end of 2020 as capital preserving measures. Historically, share repurchases account for about 70 percent of bank distributions to shareholders. Firms were only allowed to distribute dividends if they were earning profits over the past year. The Federal Reserve also required banks to re-evaluate and resubmit their capital plans.

Large banks ended 2019 with an aggregate common equity ratio of 12.0 percent. That ratio stood at 12.9 percent at the end of the fourth quarter of 2020. On December 18, 2020, the Federal Reserve published the results of its second round of stress tests for the year.[2] The December 2020 Stress Test results indicated that, while firms are projected to experience higher losses, they will remain well positioned to continue lending to households and businesses. Nonetheless, in light of the ongoing economic uncertainty and to preserve the strength of the banking sector, the Federal Reserve extended restrictions on distributions, with modifications. For the first and second quarter of 2021, both dividends and share repurchases are limited to an amount based on income over the past year. If a firm does not earn income, it will not be able to pay a dividend or make repurchases.

We took these measures in large part because the COVID event was the first serious test of our revised capital regime and stress testing framework since the Great Financial Crisis. Although our stress tests repeatedly showed the system had ample capital to meet the challenges it faced while maintaining the planned distribution of capital to investors, it was prudent for this first shock to adopt a belt and suspenders approach and put some additional limits on distributions until we saw how the system performed in a true stress event.

As noted in the response to question 1, the Board announced that the temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, following completion of the upcoming round of stress tests.

**3. Vice Chair Quarles, in March 2020, the Fed finalized a rule to combine elements of the stress testing regime and the Basel III capital requirements to create a new stress capital buffer (SCB) requirement. The Fed's analysis showed the stress capital buffer would yield similar levels of required capital "over the business cycle." Has your analysis shifted at all since then? Has this rule allowed any banks to reduce their capital levels when they are facing large potential future losses due to the pandemic?**

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[1] See https://www.federalreserve.gov/publications/files/2020-dfast-results-20200625.pdfand https://www.federalreserve.gov/publications/files/2020-sensitivity-analysis-20200625.pdf.

[2] See: https://www.federalreserve.gov/publications/files/2020-dec-stress-test-results-20201218.pdf.

Consistent with the stress capital buffer rule released in March 2020, large banking organizations have been subject to the stress capital buffer requirement as of October 1, 2020. Accordingly, the stress capital buffer requirement has been in effect for one quarter, making it too early to provide actual results over a business cycle rather than data-driven projections, which continue to show similar capital levels over the business cycle. In June 2020, the Board released the results of its annual stress test and additional analysis in light of the COVID event. Those results demonstrated that large banking organizations generally had strong levels of capital. Given the uncertainty in economic conditions, the Board, at that time, put several restrictions in place to help ensure that these firms would preserve capital. In December 2020, the Board released a second round of stress test results, which also showed that large banking organizations continued to have strong capital levels. Concurrent with the release of those results, the Board extended the restrictions on capital distributions with modifications until March 31, 2021. As noted in the response to question 1, the Board announced that the temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, following completion of the upcoming round of stress tests.

**4. Vice Chair Quarles, Comptroller Brooks, and Chairman McWilliams, last month, the Fed, OCC, and FDIC finalized an important liquidity rule in response to the 2008 financial crisis – specifically, the Net Stable Funding Ratio (NSFR). The Net Stable Funding Ratio – which requires large banks to have a minimum amount of stable funding backing their assets over a one-year horizon – was proposed to strengthen liquidity requirements for large banks. However, compared to its initial proposal, the final rule would apply the full NSFR to only nine banking organizations compared to 21 banks, completely ignoring the collective financial stability risks of large regional banks. Why was the final NSFR rule narrowed to exempt a number of large banks that individually and collectively pose systemic risks?**

The agencies initially proposed the Net Stable Funding Ratio (NSFR) rule in 2016. Following the passage of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA), which amended section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the agencies proposed to modify the scope of application of prudential standards, including the liquidity coverage ratio (LCR) rule, and re-proposed the scope of application of the NSFR rule (the tailoring proposals). Specifically, in the tailoring proposals, the agencies proposed to better align the regulatory requirements of banking organizations with their risk profiles, taking into account their size and complexity, as well as their potential effect on systemic risk. The proposed requirements increased in stringency based on measures of size, cross-jurisdictional activity, weighted short-term wholesale funding, nonbank assets, and off-balance sheet exposures. This tailored approach was made final for the interagency LCR rule in 2019 (LCR tailoring final rule).

The NSFR final rule's tailored approach aligns with the tailoring proposals and the LCR tailoring final rule and is consistent with EGRRCPA. In addition, the NSFR final rule incorporates a tailored approach to the application of the final NSFR rule that reflects the difference in risk profiles of banking organizations. For example, the agencies apply the full NSFR requirement to firms with heightened levels of average weighted short-term wholesale funding because ongoing reliance on short-term, wholesale funding can make a banking organization more vulnerable to safety and soundness and financial stability risks. Under the NSFR final rule, the largest and most complex banking organizations—banking organizations subject to Category I and II standards, as well as those subject to Category III standards, as defined in the LCR tailoring final rule, with $75 billion or more in average weighted short-term wholesale funding—are subject to the full NSFR requirement. Banking organizations subject to Category III standards with less than $75 billion in average weighted short-term wholesale funding are subject to a reduced NSFR requirement equal to 85 percent of the full requirement. Certain banking organizations subject to Category IV standards with more than $50 billion in average weighted short-term wholesale funding are subject to a reduced NSFR requirement equal to 70 percent of the full requirement.

## Mortgage Forbearance

**5. For all four witnesses, Section 4013 of the CARES Act requires federal depository regulators to allow lenders to suspend certain accounting requirements related to loan modifications and troubled debt restructurings (TDRs), and Section 4022 of the CARES Act establishes consumer rights to be granted forbearance for federally insured mortgages. The TDR provision will soon expire, but the pandemic continues to inflict considerable damage to our economy on top of the lives that have been lost. One of the bills we are considering today, the Protecting Consumers and Small Businesses through Forbearance Act, would extend the TDR provision under the CARES Act through next June while also requiring these institutions to provide forbearance and loan modifications to consumers and small business owners. What are your agencies doing to encourage banks and credit unions to do all they can to help consumers and small business owners that need forbearance on their obligations?**

The Federal Reserve has worked closely with the other banking regulators on the Federal Financial Institution Examination Council (FFIEC) to issue several statements that encourage financial institutions to work with their borrowers. In April 2020, the FFIEC, in consultation with state financial regulators, issued an interagency statement encouraging financial institutions to work constructively with borrowers affected by the COVID event and reiterating the agencies' views on consumer protection considerations.

The Federal Reserve issued guidance regarding Small Business Administration (SBA) and Treasury Small Business Loan Programs (SR 20-10) to inform supervised financial institutions about several forms of relief available to small businesses affected by the COVID event. This guidance encourages financial institutions to consider participating in programs administered by the SBA (Economic Injury Disaster Loan program under Section 7(b) of the Small Business Act), as well as those programs offered by the U.S. Department of the Treasury (Treasury) Paycheck Protection Program (PPP).

To bolster the effectiveness of the PPP, the Federal Reserve supplied liquidity to participating financial institutions through the Paycheck Protection Program Liquidity Facility (PPPLF) which extended credit backed by PPP loans to small businesses. In August 2020, the FFIEC followed-up with an interagency statement, which includes principles for considering accommodation options and for restructuring safe and sound credit extensions.

The FFIEC also issued a joint policy statement providing needed regulatory flexibility to enable mortgage servicers to work with struggling consumers affected by the COVID event. In addition, the Federal Reserve has provided outreach and education on credit forbearance and loan modifications to banking institutions through its online 'Ask-the-Fed' platform and to its examiners through a digital rapid response platform.

The 2020 interagency guidance related to the COVID event loan modifications provides an interpretation of the troubled debt restructuring (TDR) rules that exist under current U.S. generally accepted accounting principles, which is governed by the Financial Accounting Standards Board. TDR relief provided by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) does not have a time limitation if the criteria laid out in section 4013 of the CARES Act are met. The CARES Act originally allowed such treatment for qualifying modifications that occurred prior to December 31, 2020. The recently passed Consolidated Appropriations Act, 2021, extended this expiration date to be the earlier of January 1, 2022, or 60 days after the termination of the national emergency. Accordingly, TDR relief for qualifying modifications made before that date need not expire on that date, but may continue for an extended period of time.

**<u>Asset Thresholds and Participation in the PPP</u>**

**6. For all four witnesses, some depository institutions have expressed concern that their participation in the Paycheck Protection Program (PPP) will temporarily push them over regulatory asset thresholds, subjecting them to additional regulation until those loans are forgiven by the Small Business Administration (SBA). Do you share these concerns?**

> **a. The Committee considered two bills that attempt to address this concern as part of this hearing. The first is the Asset Calculation Flexibility to Support Small Businesses Act, which would exempt PPP loans from these calculations through next March, with the intention to allow forgiven PPP loans to roll off a bank's balance sheet while not exempting PPP loans that are not forgiven and will need to be repaid over the next 2 to 5 years. The other is H.R. 8675, the Preventing Regulatory Penalties for PPP Lenders Act, which would exempt all PPP loans, regardless if they are forgiven or not, and limits the application to institutions with less than $15 billion in total assets. Do you have the authority to exempt PPP loans from total assets for the purposes of regulatory thresholds, or would that authority have to be granted in new legislation?**

Depository institutions and other banking organizations should not bear increased regulatory burdens as an unintended consequence of their providing emergency economic relief. Since the beginning of the COVID event, many organizations, especially community banking organizations, have experienced an unexpected and sharp increase in assets. Much of this growth, especially growth related to PPP lending, is likely to be temporary, and the increase in assets may not reflect a change in the organization's longer-term risk profile. This rise may nevertheless cause the assets of these institutions to climb above certain asset-based thresholds in relevant regulations.

To address this issue, in November 2020, the Board, in conjunction with the other federal banking agencies, issued an interim final rule to provide temporary regulatory relief from a number of asset-based regulatory and reporting thresholds. The interim final rule permits a measurement of an institution's "total assets" and related terms as of December 31, 2019, before the beginning of the COVID event. This relief means that asset growth in 2020 or 2021 will not trigger new regulatory requirements for these community banking organizations until January 1, 2022, at the earliest. The purpose of the relief is to promote further lending by such organizations and avoid potentially temporary, but significant, transition costs that community banking organizations would otherwise face to comply with new standards. The relief thereby mitigates the effect of PPP-driven growth on an institution's regulatory obligations, until those loans are forgiven by the SBA.

As demonstrated by that rulemaking, the Board has the authority to define the statutory term "total assets" for purposes of its regulations in a manner that is reasonable, including when "total assets" must be measured.

**Supporting Minority Communities**

**7. For all four witnesses, several studies have shown that communities of color are disproportionately affected physically and economically by the COVID-19 pandemic. According to a Federal Reserve Bank of New York report, Black businesses experienced the most acute decline, with a 41 percent drop. Latinx business owners fell by 32 percent and Asian business owners dropped by 26 percent. In contrast, the number of white business owners fell by 17 percent. What has your agency done to mitigate the impact of the pandemic for your minority workforce? What has the agency done to support minority communities economically during this pandemic?**

The Federal Reserve fully acknowledges that the downturn has not fallen equally on all Americans; those least able to bear the burden have been the most affected. The rise in joblessness has been especially severe for lower-wage workers, for women, and for African-Americans and Hispanics. The containment measures imposed during the COVID event have upended many lives.

At the Federal Reserve, we have taken care to ensure that employees facing hardship due to the COVID event are afforded the flexibility they need given the unique and challenging circumstances. To ensure the safety and support of Board employees and the continuity of operations during the COVID event, the Board responded quickly in a variety of ways to maintain connectivity for its employees largely working remotely and to provide information regarding benefits and personal well-being. Additionally, we continued our hiring process through a virtual interview and selection processes and conducting virtual orientations.

With regard to your second question, the emergency lending facilities created by the Board with the support and approval of the Treasury had two main goals: restoring market functioning and access to short-term funding markets; and supporting the flow of credit to households, businesses, states, localities, and communities. By doing so, these facilities sought to provide significant support for economic growth and employment.

The Federal Reserve has made intentional efforts to reach minority- and women-owned businesses as well as minority- and women-owned depository institutions through targeted outreach to inform them about the programs established under our emergency lending authority. Additionally, the Board's Office of Minority and Women Inclusion (OMWI) has engaged closely with colleagues across the Federal Reserve System (System) to ensure our programs were widely known among minority lenders and potential minority- and women-owned business borrowers. The Federal Reserve is committed to an inclusive recovery from the COVID event. For example, beginning last June and throughout the summer, we hosted and cohosted webinars on Main Street that were targeted at reaching minority- and women-owned businesses, minority depository institutions (including those supervised by the Federal Reserve), and tribal businesses to ensure there was broad awareness of Main Street and lending opportunities.

Additionally, the Paycheck Protection Program Liquidity Facility (PPPLF) has had a wide reach across various communities—with the greatest number of participants in PPPLF classified as community banks. We also have conducted outreach and partnered with community development staff across the System on a series of webinars about the PPPLF, to ensure that eligible institutions—including Community Development Financial Institutions—have the information to access the program.

I also would note that the Municipal Liquidity Facility (MLF) provided an important backstop to the municipal bond market following a period of significant strain in March 2020, helping state and local governments better manage cash flow pressures in order to continue to meet the needs of the households and businesses that they serve. Since the announcement of the MLF, municipal interest rates have fallen to historically low levels for nearly all issuers. Moreover, issuance in 2020 recovered and exceeded the previous year.

As you are aware, Main Street and the MLF expired on December 31, 2020. On March 8, the Board announced it will extend the PPPLF by three months to June 30, 2021. The extension will provide continued support for the flow of credit to small businesses through the PPP. The Board will continue to closely monitor financial conditions and market functioning broadly and will evaluate whether additional measures are needed to support the flow of credit and liquidity to creditworthy borrowers.

**8. Vice Chair Quarles, during the COVID-19 pandemic, minority depository institutions (MDIs) and Community Development Financial Institutions (CDFIs) have delivered much needed capital and relief to underserved communities, many of which have borne a disproportionate impact of the COVID-19 pandemic. In addition to establishing relief funds and services for local businesses and individuals experiencing loss of income, MDIs and CDFIs have provided mortgage forbearances, loan deferments, and modifications to help address the needs of their borrowers. The Committee has sought to provide further support to these institutions through H.R. 7993, the Promoting and Advancing Communities of Color through Inclusive Lending Act, which would provide billions of**

**dollars of investments in these community-focused institutions. How has your agency helped enhance the work of MDIs during the pandemic response? For example, what has your agency done to ensure that MDIs and minority CDFIs are able to fully participate as PPP or Main Street Lending Program lenders?**

At the Federal Reserve, our Partnership for Progress (PFP) program works throughout the System to educate examiners and Federal Reserve leadership about MDIs, the communities they serve, and the PFP program to preserve and promote MDIs.

The Federal Reserve worked jointly with other federal banking regulators to issue an interagency statement on March 22, 2020, that encouraged financial institutions to work prudently with borrowers who are or may be unable to meet their contractual payment obligations because of the effects of the COVID event.

The Board also established a site to provide answers to questions received from bankers on the effect of the COVID event and issued various statements to provide guidance on how banks should navigate the issues posed by the COVID event. PFP staff are personally involved in assisting our MDIs to understand and navigate the myriad of credit facilities available to respond to the current crisis.

Examples of the technical assistance and outreach we have provided to state member bank MDIs and CDFIs, and MDIs and CDFIs include the following:

- The Board held a WebEx meeting in May 2020 with Federal Reserve-regulated MDIs, focusing on how MDIs and their communities are managing in the COVID event.
- Federal Reserve staff also worked internally to ensure that MDIs and CDFIs are eligible for the PPPLF and Main Street. For example, PFP staff consulted with the Reserve Banks during the roll out of the PPPLF to help non-depository CDFIs gain access to the PPPLF through a correspondent lender to the Discount Window.
- Additionally, PFP staff worked to educate MDIs and CDFIs about how to access the PPPLF and Main Street.
- The Federal Reserve, through industry and MDI feedback, lowered the loan size thresholds to participate in the Main Street in order to address industry complaints by MDIs and small community banks that the program's original minimum loan threshold was too high.

**9. Vice Chair Quarles, at the hearing, the Committee considered H.R. 7946, the Federal Reserve Racial and Economic Equity Act, which would ensure the Federal Reserve carries out its duties in a manner that reduces and ultimately helps eliminate the persistent racial economic wealth gaps in the United States. Will the Federal Reserve's proposed Community Reinvestment Act reform help reduce the racial economic wealth gap and promote real fairness in our financial system? If so, will you share data and analysis with the Committee demonstrating how these reforms will help?**

Modernizing the Community Reinvestment Act (CRA) is a priority for the Federal Reserve. Towards this goal, we released an Advance Notice for Proposed Rulemaking (ANPR) in

September 2020 seeking comment on an approach to update CRA by strengthening, clarifying, and tailoring the regulations to better meet the core purpose of the CRA and to reflect the current banking landscape.

The Federal Reserve's ANPR requested feedback on a number of issues to promote financial inclusion in our financial system. For example, to strengthen the CRA's role in financial inclusion, the ANPR proposes "special provisions for minority depository institutions, as well as women-owned financial institutions and low-income credit unions," and sought feedback on "incentives for financing community development financial institutions." It also specifies that banks could receive special CRA credit for "activities in areas with unmet needs outside of assessment areas," such as in Indian Country. Additionally, the ANPR includes a specific request for feedback on modifications and approaches that would strengthen the CRA in improving credit access for minority individuals and communities.

The Federal Reserve is committed to analyzing data to understand the impact proposed CRA reforms will have on individuals and communities, including based on racial and ethnic characteristics. We intend to be transparent in sharing the results of the Board's analysis with the public and followed through by publishing CRA Analytics Data Tables that combine Home Mortgage Disclosure Act (HMDA) data, CRA small business and small farm data, and manually extracted data from CRA performance evaluations.[3] These Data Tables provide to the public a wide range of previously unavailable CRA information that we hope will be analyzed to help support and inform modernization efforts. The Federal Reserve's ANPR also discusses how this data was used to evaluate specific CRA modernization proposals.

Now that the 120-day comment period on the ANPR has closed, we are reviewing the hundreds of comments we have received and will transparently discuss our thinking and analysis behind recommended changes to CRA regulations. We believe public feedback on our analytical work is essential to ensure that CRA is strengthened while remaining true to the statutory objective of meeting the needs of low- and moderate-income (LMI) people and communities and addressing inequities in credit access. We would welcome opportunities to engage with the Committee as we pursue this important work.

**11. Vice Chair Quarles, on September 21, 2020, the Federal Reserve Board issued an Advance Notice of Proposed Rulemaking (ANPR) on its approach to modernizing regulations that implement the Community Reinvestment Act. This was after the OCC submitted its final rule on the CRA on May 20, 2020, which CRA experts and advocates believe will lead to a decrease in lending, investment and services to low- and moderate-income (LMI) communities due to its loosening of CRA-eligible activities that only partly benefit these LMI communities. How does your ANPR ensure that LMI communities are the focus in your CRA rulemaking? How have you included the feedback of all CRA stakeholders, including LMI community members, nonprofits providing lending and community development services to LMI communities, and small businesses operating in LMI communities, in developing your framework? To what extent would the Fed's ANPR combat modern-day redlining that persists throughout the country?**

[3] See https://www.federalreserve.gov/consumerscommunities/data_tables.htm.

The ANPR seeks to better meet the CRA's core purpose to improve credit access for LMI communities and ensure an inclusive financial services industry by strengthening regulations to ensure the wide range of LMI banking needs are being met. Given stakeholder feedback on the importance of both retail and community development activities, the ANPR proposes assessing large retail banks using a Retail Test and a Community Development Test with separate financing and services subtests. Separate assessments of retail lending, retail services, community development financing, and community development services will support robust bank engagement with communities through a variety of channels that are separately rated.

In addition, the ANPR promotes financial inclusion by proposing special provisions for minority depository institutions, as well as women-owned financial institutions and low-income credit unions, seeks feedback on additional incentives for financing community development financial institutions, and recognizes that fair lending is an important part of meeting communities' credit needs that should be taken into account in assigning a rating. It also specifies that banks could receive special CRA credit for activities in areas with unmet needs outside of assessment areas. The ANPR incorporates views from external stakeholders provided in meetings, roundtables, and comment letters and from all three of the banking regulatory agencies responsible for administering the CRA. The Federal Reserve will continue to engage throughout the rulemaking process, seeking the views of all stakeholders, including LMI community members, nonprofits providing lending and community development services to LMI communities, and small businesses operating in LMI communities.

**Efforts to Promote Diversity within the Prudential Regulators**

**12. For all four witnesses, the Rooney Rule is a policy that originates from the National Football League, where at least one minority and/or woman must be considered for each open leadership position. This Committee recently passed legislation, H.R. 281, Ensuring Diverse Leadership Act sponsored by Rep. Beatty, that would require the consideration of at least one person reflective of both gender and racial or ethnic diversity when filling Federal Reserve Bank president vacancies.[1] At the hearing, we also considered two other pieces of legislation - the Federal Reserve Bank Board Diversity Act and the Diversity in Financial Regulatory Advisory Committees Act - that would require consideration of at least one candidate that reflects gender diversity and one candidate that reflect racial diversity for Federal Reserve Bank boards of directors, as well as advisory committees for certain financial agencies. How could a Rooney Rule-like requirement to mandate the consideration of diverse candidates for senior staff roles improve diversity results in your agencies? How have you worked with your respective directors of the Office of Minority and Women Inclusion to increase the representation of women and minorities at all levels of your agency?**

**[1]**
**https://financialservices.house.gov/news/documentsingle.aspx?DocumentID=404291#:~:text=a%20voice%20vote.-,H.R.,bill%20was%20introduced%20by%20Rep.**

We are fully committed to strengthening our workforce diversity. This is a high priority for us and we have a tremendous amount of work going on at the Board in this area. However, we defer to Congress as to whether a Rooney Rule-like requirement would be an effective tool for increasing diversity.

With regard to our efforts in recruitment, we have engaged in extensive outreach to attract diverse candidates. This includes participating in minority recruitment events at Historically Black Colleges and Universities, Hispanic-Serving Institutions, and Hispanic professional conferences and career fairs.

To strengthen the pipeline of economists from under-represented groups, we have collaborated with the American Economic Association, partnered with Howard University, and welcomed diverse groups of students to the Board to discuss career opportunities and diversity in the profession.

Additionally, we are supporting research on and awareness of the factors that are holding back diversity and inclusion in economics. In November 2021, we are hosting a conference on Diversity and Inclusion in Economics, Finance, and Central Banking, along with three other central banks.

**Industrial Loan Companies (ILCs) and Fintech Charters**

**18. Vice Chair Quarles, in the past, the Federal Reserve has advocated that ILCs be subjected to enhanced scrutiny, noting that ILCs like GM's GMAC became heavily involved with subprime mortgages and incurred major problems during the 2008 financial crisis. Is the Fed comfortable with the FDIC's move to grant the first ILC charters since the 2008 crash, or does the Fed still support its past recommendation that ILCs be subject to the Bank Holding Company Act, like other federally-insured banks?**

In general, institutions that are similar to one another in function should be subject to similar regulation. When the same economic activity can be conducted through different legal structures subject to different regulatory restrictions, this can create an incentive for risky activities to concentrate in specific parts of the financial system, rather than to be distributed across a variety of institutions with the attendant resilience that such diversity usually promotes. Congress has provided a statutory exemption from the Bank Holding Company Act for industrial loan companies (ILC), which places those institutions outside of the Board's supervision and regulation. Thus, whether an ILC is subject to substantially similar regulation as a bank holding company (BHC) when it engages in similar activities will be a function of the Federal Deposit Insurance Corporation's (FDIC) oversight of these firms, including any commitments made by the firms to the FDIC as part of the FDIC's approval of the ILC's application for deposit insurance.

There is no inherent reason that the FDIC cannot impose appropriate conditions to the approval of an ILC's application for deposit insurance that would address some of the key disparities that have been cited. Federal Reserve supervision of holding companies is complex, however, and it would be difficult to replicate the regulatory framework fully to create a truly level playing field between BHCs and ILCs.

Market Concentration and Mergers

**20. Vice Chair Quarles, during its annual policy symposium this past August, policymakers at the Federal Reserve reviewed a new research paper that found that, "[t]he rise in market concentration and the fall in labor share [of income] are positively associated." Researchers at the Fed seem to recognize that growing market concentration is a major challenge for the economy over the next decade, and yet at the end of September, the Fed approved an acquisition involving TD Bank and Charles Schwab, and a merger between Morgan Stanley (a global systemically important bank) and E*Trade. Why is the Fed continuing to allow market concentration to get worse amidst a pandemic that is actively swallowing up what remains of small businesses in this country? Considering the research showing the negative impact mergers and acquisitions have on hardworking people, and considering the economic uncertainties due to the pandemic, shouldn't the Fed at the very least put a pause on these major mergers and acquisitions until the pandemic is over and the economy is stable?**

The Board reviews merger and acquisition proposals very thoroughly under the statutory framework established by Congress. The Board is subject to statutory timelines in acting on proposals such as the TD and Morgan Stanley transactions and does not have the unilateral ability to suspend these timelines. The Board considered the effect of the COVID event on the parties and proposed transactions in taking final action on the TD and Morgan Stanley notices. The TD and Morgan Stanley proposals were subject to review under section 4 of the Bank Holding Company (BHC) Act. Section 4 requires the Board to consider whether the public benefits of a proposal can reasonably be expected to outweigh possible adverse effects. As part of its evaluation, the Board reviews, among other factors, the effect of the proposal on competition in the relevant markets and risks to the stability of the U.S. banking or financial system. Based on its analysis of the records, the Board concluded that all statutory factors that it was required to consider in the TD and Morgan Stanley cases, including as related to competition, were consistent with approval.

**22. Vice Chair Quarles and Acting Comptroller Brooks, with respect to the proposed merger of PNC Financial Services and BBVA USA, given this merger would create the fifth largest U.S. bank with more than $500 billion in consolidated assets, will your agencies be holding public hearings to ensure affected employees, consumers, communities and other stakeholders have a full opportunity to be heard on the proposed merger? In reviewing the proposed merger, will your agencies consult with the Treasury Secretary, in their role as the Chair of the Financial Stability Oversight Council, considering the impact the merger may have on systemic risk? Also, will your agencies consult with the Consumer Financial Protection Bureau considering potential impacts the merger may have on consumers? Will you evaluate whether the proposed merger of the banks makes diversity and inclusion an intentional priority?**

Under section 3 of the BHC Act, proposals such as the PNC/BBVA transaction are subject to public notice and comment. Any member of the public, including affected employees, consumers, communities, and other stakeholders may submit comments, and the Board will take into consideration comments on whether the proposal is consistent with the statutory factors when evaluating and acting on the application. The Board typically considers a number of factors in determining whether to hold a public meeting, including: the nature and significance of the proposal (e.g., the nature of the parties' businesses or the size of the transaction), public interest in the proposal, and whether a public meeting is likely to elicit information meaningful to the Board's consideration of the statutory factors. The Board did not receive any adverse comments or requests for a public meeting on the PNC proposal.

In acting on an application under section 3 of the BHC Act, the Board is required to consider a number of factors, including the effect of the proposal on financial stability and the convenience and needs of the communities to be served.[4] The BHC Act does not provide for consultation between the Board and the Financial Stability Oversight Council in connection with the Board's evaluation of the financial stability effects of a proposal under the BHC Act.

When evaluating proposals involving financial institutions subject to Consumer Financial Protection Bureau (CFPB) supervision, the CFPB's supervisory records on the institutions are taken into consideration in the Board's analysis of the consumer compliance records of the firms involved in the application, as are the views of the relevant prudential regulators. PNC Bank and BBVA Bank are subject to CFPB supervision, and the Board will consult with the CFPB and take into consideration CFPB supervisory views in evaluating the PNC/BBVA application.

**23. Vice Chair Quarles and Chairman McWilliams, regarding the proposed purchase of CIT by First Citizens bank – which would create the 19th largest bank in the country with nearly $110 billion in total assets –will you commit to holding public hearings that ensure all affected parties, including community organizations, and current consumers of CIT or First Citizens, are able to share their perspectives, and to help stakeholders better understand the potential impact on local bank branches and their employees? Will your agencies commit to reviewing the community reinvestment and fair housing records and obligations of the merger? Will you consult with the CFPB, HUD, and any other relevant federal agencies to determine the impact on credit access by local consumers and on the availability of consumer choice in the affected areas? Will you evaluate whether the proposed merger of the banks makes diversity and inclusion an intentional priority?**

As noted, proposals under section 3 of the BHC Act, such as the CIT/First Citizens matter, are subject to public notice and comment. In deciding whether to hold a public meeting on a proposal, the Board considers the factors noted in response to question 22. The Board did not receive any adverse public comments or requests for a public meeting on the CIT/First Citizens proposal.

Under section 3 of the BHC Act, the Board is required to consider the convenience and needs of the communities to be served in acting on proposal.[5] As part of its evaluation of the convenience and needs factor, the Board considers the consumer compliance, including fair lending, records of the involved firms. The Board also is required to consider the Community Reinvestment Act (CRA) records of the firms. In evaluating the First Citizens/CIT application, the Board will take

[4] 12 U.S.C. §§ 1842(c)(2) and (7).
[5] 12 U.S.C. § 1842(c)(2).

into consideration the consumer compliance, including fair lending, and CRA records of the parties.

As noted in response to question 22, when evaluating proposals involving financial institutions subject to CFPB supervision, the CFPB's supervisory records on the institutions are taken into consideration in the Board's analysis of the consumer compliance records of the firms involved in the application, as are the views of the relevant prudential regulators. The bank subsidiaries of First Citizens and CIT are subject to CFPB supervision. The Board will consult with the CFPB and take into consideration the CFPB's supervisory views in evaluating the First Citizens/CIT application.

**Public Bank Ratings**

**24. Chairman McWilliams and Vice Chair Quarles, late last year, the FDIC and Federal Reserve requested public comment on the Uniform Financial Institution Ratings Systems, better known by the CAMELS acronym that governs how banks are rated by regulators. As the COVID event continues, questions remain about how the related downturn may affect the safety and soundness of banks. Research by the Federal Reserve Bank of Boston suggests that improving disclosure at troubled U.S. banks during a banking crisis would not destabilize the financial system and would provide conditions for market discipline to work more effectively.[1] Furthermore, the Dodd-Frank Act created a new failure resolution framework that regulators and policy makers have expressed great degree of confidence in containing potential contagion from the failure of any single large financial institution. Do you agree that publicly releasing CAMELS ratings would promote market discipline? Additionally, do you believe it would help serve as deterrent for risky business practices?**

**[1] https://www.bostonfed.org/publications/research-department-working-paper/1999/the-impact-of-greater-bank-disclosure-amidst-a-banking-crisis.aspx**

A supervisory rating is a confidential assessment of the strength of a bank in one or more risk areas, or, in some cases, a composite view of the aggregate risks facing the bank. Ratings date back to the first half of the 20th century, and possibly earlier, when they were used to classify banks, in much the same way as examiners assign ratings today. The modern version of ratings was the result of the establishment by Congress of the FFIEC in 1978. The FFIEC established the "CAMEL" rating system in the same year to promote consistent examination practices across depository institutions. The Federal Reserve followed suit with a supervisory rating system for bank holding companies in 1979. Since that time, ratings have become enshrined in the federal banking laws. In particular, they play a role in interstate branching requirements and in determining whether or not holding companies can engage in expanded financial activities.

Supervisory ratings are protected as confidential supervisory information for two primary reasons. First, some degree of confidentiality is desirable to ensure the security of financial institutions and to protect against unintended and adverse effects that might result from the disclosure of certain types of sensitive supervisory information. This could include customer data, proprietary market intelligence, or even candid supervisory assessments, such as control weaknesses in critical operating infrastructure, the public exposure of which might compromise banks' safety. Second, confidentiality can help foster a relationship of trust between supervisors and the institutions, enabling frank dialogue and creating an environment in which bank management may be more likely to cooperate with examiners.

The Federal Reserve has taken steps to provide information to the public around the rating process. For example, the standards we use to assign the ratings have always been published. In addition, the Board has sought public comment on the two most recent iterations of its ratings systems for holding companies, the RFI rating system and the LFI rating system. And in 2019, the Board began publishing aggregate data on supervisory ratings—organized by different bank cohorts—as part of its Supervision and Regulation Report.[6]

The Federal Reserve continues to explore ways to increase accountability and transparency in supervision, including whether greater disclosure of firm-specific information would facilitate market discipline and deter risky business activities. This involves a careful consideration of the process by which such disclosure might occur and what, if any, standards might govern it.

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[6] https://www.federalreserve.gov/publications/supervision-and-regulation-report.htm.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

February 19, 2021

The Honorable Anthony Gonzalez
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on December 2, 2020.

**Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Gonzalez:**

**1. For the OCC, Federal Reserve, FDIC: What is your view of the benefits of Fannie Mae and Freddie Mac's use of credit risk transfer as a way of attracting loss absorbing capital for mortgage credit risk?**

Credit risk transfers could attract some loss-absorbing capital, but the design of the credit risk transfer program is important for determining its usefulness. The experience of the last year has shown that the usefulness of credit risk transfers may be limited when there is a lot of uncertainty in mortgage or housing markets. Moreover, depending on the parameters of the credit risk transfer program, the capital generated may not be available when losses are incurred, particularly after periods of high refinancing. A credit risk transfer program may not adequately cover uncollateralized counterparty risk or the risk of loss after a particular deal expires. In addition, capital generated by credit risk transfers is generally not available to be allocated across reference pools. In contrast, equity capital can be allocated to cover losses across the entire portfolio.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

February 26, 2021

The Honorable Joyce Beatty
House of Representatives
Washington, D.C. 20515

Dear Congresswoman:

Enclosed is my response to the question you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on December 2, 2020.

**Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Beatty:**

**1. This question is for Vice Chairman Quarles.**

**Last month, professors from the University of Texas and MIT issued a paper entitled, "Are CLO Collateral and Tranche Ratings Disconnected?" In this paper, they found that between March and August 2020, S&P and Moody's downgraded approximately 25% of the collateral feeding into Collateralized Loan Obligations (CLOs), while the total value of the tranches of CLOs were only downgraded by 2%. This suggests that CLOs are much riskier that their current ratings are suggesting.**

**Are you aware of this study? Has the Federal Reserve looked at this potential mismatch between CLO collateral and tranche ratings?**

We are aware of this study and closely follow developments in the collateralized loan obligations (CLO) market—including research on CLOs—as part of our efforts to assess financial stability. The November 2020 Financial Stability Report (page 52), for example, discussed downgrades last year in the loan collateral underlying CLOs and the actions that CLOs took in response to such downgrades.

The share of downgrades in CLO collateral and downgrades in CLO tranches should not be expected to be equal due to the design of CLO securities. Moreover, the key point of the paper is not that the 2 percent downgrade in CLO tranches is less than the 25 percent downgrade in CLO collateral, but that 2 percent is lower than what would have been the case had rating agencies followed the projections they made before the COVID event. Consequently, the paper concludes that the current ratings of CLOs are inflated, particularly for higher-rated tranches.

That said, the conclusion of CLO ratings inflation does not necessarily follow as automatically as the paper suggests. First, CLOs are actively managed, and CLO managers buy, sell, and substitute loans in the CLO collateral pool to improve the yield on the portfolio and to minimize losses. Reflecting this, between March 2020 and August 2020, CLO managers actively traded out of low-rated loans, which, other things being equal, would have probably improved their ratings. However, this trading does not necessarily mean CLO managers exploit rating methodologies to avoid tranche downgrades. Managers could also be selling downgraded loans to pass collateral tests that affect their ability to distribute cash flows back to investors. Second, market prices of CLOs do not seem to reflect a ratings discount. Prices for CLOs that could have been affected by ratings inflation and those issued after the COVID event, and hence less affected, followed a similar pattern since the COVID event. Third, CLO investors are predominately sophisticated institutional investors with access to regular CLO disclosures of holdings and should be able to assess relatively accurately the underlying quality of CLOs.

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RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

February 26, 2021

The Honorable Stephen Lynch
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

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**<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Lynch:</u>**

**1. Vice-Chair Quarles: The Federal Reserve recently amended the terms of the Main Street Lending Program in order to expand the program's reach to smaller sized businesses. Given the ongoing economic uncertainty, particularly in the small business sector, as well as the continued inability of Congress and the administration to provide additional legislation addressing the needs of the small business marketplace, do you believe the Fed should consider creating additional facilities specifically aimed at supporting the small business community?**

Pursuant to section 1005 of the Consolidated Appropriations Act, 2021 (the Act), the Main Street Lending Program (Main Street) terminated on January 8, 2021, and the Act prohibits the Treasury and the Federal Reserve from establishing a facility that is the same as Main Street. The Federal Reserve will continue to closely monitor financial conditions and market functioning broadly, including the flow of credit and liquidity to creditworthy borrowers.

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RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

February 19, 2021

The Honorable Ben McAdams
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

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**Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative McAdams:**

**For Vice Chair Quarles:**

**Earlier this year, the committee launched a bipartisan Counter-Trafficking Initiative that is designed to explore and expose the breadth and reach of transnational trafficking networks and their illicit finances. And the House recently passed my bipartisan legislation, the STIFLE Act, that aims to crack down on these trafficking networks by targeting money laundering and illicit financial networks used by criminals. Clearly our financial institutions play a key role in helping stop these illicit flows.**

**Can you speak to the current state of our domestic BSA/AML requirements, and what additional tools our regulators or financial institutions can bring to the fight to stop sophisticated, often transnational, trafficking networks, such as those engaged in human trafficking? What else do you or those entities need?**

**What role do international efforts and cooperation play in stopping these illicit trafficking networks?**

The Federal Reserve is working in support of the U.S. efforts to combat human trafficking and other illicit activities that endanger the safety and security of our most vulnerable populations. As stated by the U.S. Department of the Treasury (Treasury), money laundering linked to human trafficking is one of the most significant illicit finance threats facing the United States. The Bank Secrecy Act (BSA) requires banks and other financial institutions to maintain an effective anti-money laundering (AML) program and report suspicious transactions involving potential violations of law, including human trafficking, to the Treasury's Financial Crimes Enforcement Network (FinCEN). Moreover, as supervisors, we expect financial institutions to comply with valid law enforcement requests seeking to identify or seize assets connected to illegal activity. Congress has granted the Federal Reserve the tools necessary to ensure the institutions we supervise comply with the BSA and its implementing regulations. The Federal Reserve relies on this authority to examine supervised institutions for compliance with the BSA and to require, in appropriate circumstances, remedial actions to address concerns in an institution's BSA/AML program. The Federal Reserve provides its examiners with information related to BSA/AML issues, such as human trafficking, through its training programs and other means.

In addition, the Federal Reserve works with other federal banking agencies and FinCEN through the Federal Financial Institutions Examination Council (FFIEC) to ensure that its examiners receive consistent training on important topics such as human trafficking.[1] Specifically, the FFIEC Advanced BSA/AML Specialists Conference and the FFIEC Financial Crimes Seminar have held 13 training sessions focused on human trafficking for over 2,500 attendees since 2016.

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[1] See U.S. Department of the Treasury, Report to Congress on An Analysis of Anti-Money Laundering Efforts Related to Human Trafficking Section 7154(a) of the National Defense Authorization Act for Fiscal Year 2020, https://home.treasury.gov/system/files/136/Report-Money-Laundering-Human-Trafficking.pdf (visited January 5, 2021).

Effective coordination with other prudential supervisors and law enforcement is critical to the success of our supervisory and enforcement programs. International efforts and cooperation also play an important role in certain aspects of bank supervision, including by raising awareness of issues related to illicit financial activity like human trafficking. For example, the Federal Reserve participates in the U.S. delegation to the Financial Action Task Force (FATF), the international standard-setting body for AML and countering the financing of terrorism requirements. Among other things, FATF uses its platform to highlight relevant financial crime issues such as human trafficking, as well as to alert banks to recent typologies and red flags.[2]

**For Vice Chair Quarles:**

**The Federal Reserve recently released an Advanced Notice of Proposed Rulemaking related to the Community Reinvestment Act – and this is after the OCC finalized its CRA rulemaking earlier this year.**
**You and I have spoken about the importance of the CRA in the past, and particularly its importance to my state of Utah. And we've also spoken about the need to preserve the spirit and the intent of the CRA to benefit low- and middle-income communities and individuals while also updating the CRA for a 21st Century financial system – and I have a particular interest in incentivizing outcomes-based investments.**
**Can you speak to the goals of the Fed's ANPR, and how the Fed's approach is similar or different than the approach taken by the OCC?**

**And on an issue many of my colleagues have focused on, can you speak to how the Fed views the importance of physical locations, such as branches, in determining assessment areas for CRA compliance?**

Building on ideas advanced by stakeholders, the Federal Reserve Board (Board) is seeking comment on an approach to modernize the Community Reinvestment Act (CRA) by strengthening, clarifying, and tailoring the CRA regulations to reflect the current banking landscape and better meet the core purpose of the CRA. The Advance Notice of Proposed Rulemaking (ANPR) seeks to better accomplish the CRA's core purpose to address inequities in credit access for low- and moderate-income (LMI) communities and ensure an inclusive financial services industry; provide more certainty and consistency, tailor regulations, and minimize burden; and provide a foundation for the agencies to converge on a consistent approach that has broad support among stakeholders.

The Federal Reserve is committed to converging on a consistent approach with the other federal financial agencies and building on the broad agreement between the agencies regarding the goals and objectives of CRA modernization. While differences exist, the Federal Reserve also has benefitted from extensive interagency discussions on CRA reform, both in discussing the stakeholder feedback on challenges with the current regulation, as well as specific reform ideas.

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[2] See, e.g., FATF Reports, Financial Flows from Human Trafficking, https://www.fatf-gafi.org/media/fatf/content/images/Human-Trafficking-2018.pdf (July 2018); Money Laundering and the Illegal Wildlife Trade in 2020, http://www.fatf-gafi.org/media/fatf/documents/Money-laundering-and-illegal-wildlife-trade.pdf (June 2020); and Trade Based Money Laundering: Trends and Developments, https://www.fatf-gafi.org/media/fatf/content/Trade-Based-Money-Laundering-Trends-and-Developments.pdf (December 2020).

The Federal Reserve included a number of ideas from the Office of the Comptroller of the Currency (OCC) and Federal Deposit Insurance Corporation's (FDIC) Notice of Proposed Rulemaking in the proposal, such as a pre-approval process and illustrative list of qualifying activities. Among other provisions, the agencies also both propose to clarify naturally occurring affordable housing for CRA consideration, and to provide additional eligibility in Indian Country.

However, some differences remain regarding how to achieve the broad goals and objectives we believe all three agencies share. For example, while all agencies favor utilizing metrics to increase up-front clarity and certainty on how banks will be evaluated, the Board's ANPR seeks to tailor the use of metrics and CRA evaluations to reflect differences in bank sizes and business models, as well as differences in community conditions and across business cycles. The ANPR also takes additional steps to minimize data burden—particularly for small banks, which would not be required to collect or report additional data.

In the 25 years since the CRA regulation was last substantially revised, the banking landscape has changed, and use of mobile and internet banking has increased. The ANPR proposes to modernize CRA assessment areas, while still maintaining a focus on branches, given their importance to individuals and communities.

Community and industry stakeholders have expressed that bank branches remain as important as ever to their local communities. Research also shows bank branches are a critical link for access to credit and other financial services for many, especially older populations, rural residents, and LMI communities. The ANPR proposes evaluating retail services with new quantitative benchmarks that focus on branches as a core component of delivering retail services. It also provides options to more predictably delineate assessment areas around physical locations, such as bank branches, and to ensure that assessment areas are contiguous, do not reflect illegal discrimination, do not arbitrarily exclude LMI census tracts, and are tailored to bank size and performance context.

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WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

February 19, 2021

The Honorable John Rose
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the November 12, 2020,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

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[1] Questions for the record related to this hearing were received on December 2, 2020.

**Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Rose:**

**Vice Chair Quarles:**

**Question 1:**

**Nearly 60 percent of ATMs in the United States are independent, nonbank terminals. It is those ATMs that are typically found in low-income communities; and thinly populated rural areas, in which there are few, if any, bank offices or bank-owned ATMs.**

**The widespread closures and denials of bank accounts to businesses within the independent, nonbank ATM industry present a serious threat to the financial stability not only of consumers who live in the areas served almost exclusively by independent, nonbank ATMs, but also the tens of thousands of retail and service businesses serving these consumers daily.**

**In a Financial Services hearing on February 15, 2018, National ATM Council's (NAC) Tim Baxter testified that the quote "widespread and severe consequences that in recent years have resulted from financial institutions' practice of 'de-risking'" end quote and the prejudicial treatment that was a direct result of federal regulators' implementation of Operation Choke Point in 2013. He noted that it is impossible for ATM operators to do business without having a bank account, but even with the end of the Operation Choke Point initiative, independent ATM providers were increasingly being "notified by their banks, without explanation, that their deposit accounts [were] to be closed, or, in some cases, already [had] been closed."**

**Question: Could you describe what the regulators are doing to address the fallout from Operation Chokepoint and its effect on ATM owners and operators who are still having their accounts closed?**

It is the longstanding policy of the Federal Reserve that banking organizations are neither prohibited nor discouraged from providing accounts or services to any class or type of law-abiding businesses. The decision to establish, limit, or terminate a particular customer relationship is a decision to be made by the banking organization, and may be based on various factors, including the banking organization's particular business objectives, its evaluation of the risks associated with offering particular products or services, and its capacity to effectively manage those risks. The Federal Reserve's supervisory expectation is that banking organizations apply appropriate policies, procedures, and processes to address the risks associated with a particular customer relationship in accordance with the Bank Secrecy Act (BSA). Operation Choke Point was an initiative of the Department of Justice in which Federal Reserve staff did not participate.

The Federal Reserve has taken a number of steps to make sure that its policies are widely known to supervised banking organizations and to Federal Reserve examiners with responsibility for evaluating compliance with the BSA. For example, Federal Reserve staff participates in the Federal Financial Institutions Examination Council (FFIEC), which has been revising the BSA/AML Examination Manual (Manual) used by all the federal banking agencies to emphasize the risk-based approach that should be used when reviewing an institution's BSA compliance program. To that end, Federal Reserve and FFIEC staffs are actively considering revisions to the section of the manual concerning privately-owned ATMs to better emphasize these principles and incorporate the feedback we have received from the privately-owned ATM industry, as appropriate. The Federal Reserve is also committed to providing periodic training to examiners to ensure that they are familiar with our supervisory expectations and policies in this area.

**Question 2:**

**S.2155 was passed by Congress in 2018 and made great strides to tailor regulations to take into account a financial institution's size and business model.**

**Question: In your view, does tailoring regulations support communities served by small and midsized banks and credit unions while ensuring safety and soundness at those institutions? What more can Congress do to encourage this trend?**

Regulations issued by the Federal Reserve are designed to promote the safety and soundness of individual banking organizations and of the financial system more generally. In addition, the Federal Reserve strongly supports the underlying principle in S. 2155 that regulation and supervision should be tailored to the risk, size, and complexity of a banking organization. Accordingly, the Federal Reserve is committed to tailoring supervision and reducing regulatory burden where appropriate, particularly for community banking organizations (CBOs).

Consistent with certain provisions of S. 2155, the Federal Reserve, together with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (the agencies) recently finalized several rules to reduce regulatory burden for CBOs, such as the community bank leverage ratio rule, reducing call reporting requirements, and exempting small banks from the Volcker rule. With respect to tailoring supervision, the Federal Reserve supports initiatives to tailor not just across portfolios, but also within portfolios. The Federal Reserve also took several actions to balance the safety and soundness of community banks with the operational challenges during the COVID event. Specifically, the agencies paused examinations at CBOs for a period of time to allow community banks to adjust their operations and serve the needs of their communities. The agencies also extended the deadline for the regulatory report submission for the first quarter of 2020, and provided temporary relief on the community bank leverage ratio requirement.

The Federal Reserve has also considered ways to tailor the supervisory program for CBOs. Tailoring supervisory programs allows the Federal Reserve to achieve its goal of promoting a strong banking system and preventing or mitigating against the risks of bank failures while minimizing regulatory burden to CBOs. Some examples of recent actions to tailor supervision of CBOs include: (1) heightened reliance on the supervisory work of the primary regulator for the depository institution subsidiaries in supervising community and regional holding companies; (2) removal of community banking organizations from any centrally coordinated horizontal supervisory programs; and (3) implementation of a structured program, known as BETR, or Bank Exams Tailored to Risk, that tailors supervision based on size, complexity and risk profile of the institution.

The Federal Reserve also shifted the focus of CBO supervisory activities during the crisis period to assessing the overall safety and soundness of an institution as well as the effectiveness of an institution's risk management and responsiveness to changing economic and market conditions. One of the primary goals of the Federal Reserve's supervisory approach is to ensure the resilience of CBOs while not impeding the flow of credit that is vital for economic recovery.

Therefore, where possible, the Federal Reserve will streamline the supervisory review of lower-risk, well-managed CBOs in sound financial condition while focusing its supervisory attention on high-risk CBOs as warranted by facts and circumstances.