

OVERSIGHT OF FINANCIAL REGULATORS

HEARING
BEFORE THE
COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
ONE HUNDRED SIXTEENTH CONGRESS
SECOND SESSION
ON
RECEIVING TESTIMONY FROM FEDERAL FINANCIAL REGULATORY
AGENCIES REGARDING EFFORTS, ACTIVITIES, OBJECTIVES, AND
PLANS WITH RESPECT TO REGULATORY AND SUPERVISORY ACTIVI-
TIES FOR FINANCIAL INSTITUTIONS, CREDIT UNIONS, AND OTHER
REGULATED ENTITIES

NOVEMBER 10, 2020

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OVERSIGHT OF FINANCIAL REGULATORS

TUESDAY, NOVEMBER 10, 2020

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met, via Webex, at 2:32 p.m., Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. This hearing will come to order.

Before we get going, a few videoconferencing reminders. Once you start speaking, there will be a slight delay before you are displayed on the screen, and do not worry about that.

To minimize background noise, please click the mute button until it is your turn to speak or ask questions. If there is a technology issue, as usual, we will move to the next Senator until it is resolved. And, again, I remind all Senators and our witnesses that the 5-minute clock still applies, and you should all have one box on your screens labeled “Clock” that will show how much time is remaining. I will try to remember to gently tap the gavel to remind Senators of their time because we seem to always have one or two who do not have the clock in front of them.

To simplify the speaking order process, Senator Brown and I have again agreed to go by seniority for this hearing.

With that, today we welcome to this virtual hearing the Federal prudential regulators: Federal Reserve Vice Chairman of Supervision, Randy Quarles; Acting Comptroller of the Office of the Comptroller of the Currency, Brian Brooks; Chairman of the Federal Deposit Insurance Corporation, Jelena McWilliams; and Chairman of the National Credit Union Administration, Rodney Hood.

We will receive testimony from each agency on efforts, activities, objectives, and plans since you last testified before the Committee, as well as an update on COVID-19-related actions.

Since the passage of the Coronavirus Aid, Relief, and Economic Security Act, or CARES Act, your agencies have taken many meaningful steps to mitigate the economic impact of the pandemic and to provide conditions that will lead to a forceful recovery.

On October 30, the Federal Reserve announced changes to its Main Street Lending Facility, including decreasing the minimum loan size for the new loan and priority loan facilities from \$250,000 to \$100,000, and allowing borrowers to deduct any PPP loan less than \$2 million from their outstanding debt for the purposes of the leverage test.

Your agencies should continue to carefully review the regulatory and supervisory frameworks, adjusting where necessary to bolster financial institutions' ability to support economic recovery—which, by the way, has shown positive signs of recovery over the last several months.

On October 29, the United States GDP surged a record 33 percent in the third quarter as the economy started to reopen.

The unemployment rate fell to 6.9 percent in October. Just last spring CBO projected that we would still be at 9.5 percent by the end of 2021.

And since April, around 12 million jobs have been gained, meaning we have recovered more than half of the jobs lost due to the Government-enforced shutdowns.

Over the last few months, I have sent several letters to the regulators on a number of important issues.

On July 31, I sent a letter to each of the agencies urging the use of existing discretion to extend relief provided under Title IV of the CARES Act, including extending the Community Bank Leverage Ratio to December 31, 2021; the Troubled Debt Restructurings, or TDRs, to January 1, 2022; and the Current Expected Credit Losses, or CECL, methodology to January 1, 2023, while clarifying and minimizing unintended effects of mid-year adoption.

On October 8, I sent the regulatory agencies a letter regarding the increase in regulatory burden for banks and credit unions simply due to their rapid implementation Paycheck Protection Program, or PPP.

As a result of their critical role in PPP and the economic recovery, many banks and credit unions inadvertently experienced significant balance sheet growth, which is ultimately expected to decline as borrowers meet the PPP's forgiveness terms.

The FDIC took an important step in issuing an interim final rule to alleviate the increased Part 363 audit and reporting requirements for insured depository institutions that have experienced growth from PPP and participation in the Federal Reserve 13(3) facilities, and other stimulus efforts.

It is important that banks and credit unions are not inadvertently disincentivized from continuing to play a key role in the economic recovery or to participate in future efforts.

I urge each of you to continue using your discretion to alleviate the regulatory burdens associated with a variety of asset-based regulatory thresholds on those banks and credit unions who are temporarily experiencing growth from participation in recovery-oriented programs.

Turning to the OCC, on October 19, the Senate rejected a Congressional Review Act of the Community Reinvestment Act issued by the OCC.

According to the OCC, the final rule improves Community Reinvestment Act regulations “by clarifying what qualifies for CRA consideration, updating how banks define their assessment areas, evaluating bank CRA performance more objectively, and making the entire process more transparent and timelier. The final rule’s framework will increase support to small business, small- and family-owned farms, Indian Country, and distressed areas, and it accommodates banks of all sizes and business models.”

The CRA had not been materially modernized since 1995, and I commend the OCC for taking this important step.

As we continue to weather this pandemic, I again stress to each of you and your agencies the importance of our financial institutions providing access to credit and financial services to credit-worthy individuals and businesses in legal industries.

It is vitally important that our country's financial institutions, especially the largest, not deny credit financing based on political preferences related to firearms, oil and gas, or others.

Lending decisions should be based on creditworthiness and should not target specific industries, especially as we work to restore our economy to pre-pandemic strength.

This will remain an incredibly important issue for me, and I will continue to fight for access to credit and financial services for all of our legal industries.

I appreciate each one of you joining us today to share your agency's activities and plans, as well as the tireless work of you and your staff in response to COVID-19.

Senator Brown.

OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman.

The American people sent a clear message in this election: they rejected an Administration where Wall Street and corporations run the economy. People want a Government that is actually on their side.

For the past 4 years, the Trump administration and the Federal financial regulators before us today have put their thumbs on the scale for corporations and their wealthy friends, while leaving everyone else at the mercy of the supposed "free market."

Americans watched a President ignore a pandemic, refuse to even try to put in place any kind of plan to bring the virus under control, and to reject all our efforts to support families and get our economy running smoothly.

Whatever the Majority Leader may say, whatever damage he and some of my colleagues and the outgoing President are doing to our democracy with their lies and their fabricated attacks on our non-partisan and hardworking poll workers and local election officials, the facts are clear: A decisive majority of the public—5 million more people voted for Joe Biden than Donald Trump—a decisive majority rejected what they have endured over the last 4 years and voted for new leadership that will restore faith in our Government.

People are ready to turn the page. They are ready for real leadership that will give them their freedom and their lives back. They are ready to heal and rebuild.

The work we do here on the Banking and Housing Committee can be a big part of that and can make a real, tangible difference in people's lives—if we, Committee Members of both parties, come together and choose to do so.

We have the power on this Committee to tackle the issues that actually matter to people's lives—their paychecks, housing, transportation, and the communities they live in.

We can put small businesses back on their feet. We can lift up Brown and Black communities that have been hit the hardest by

this pandemic. We can keep people in their homes; we can make their homes more affordable; we can bring down people's energy bills. We can lead the world in the fight against climate change. We can seize every opportunity to create good-paying jobs. We can free people from the stress of debt collectors and the downward spiral of payday lenders. And we can reorient our economy from wealth to work.

To do all of that, we have to take on Wall Street power.

We know who ships jobs overseas. We know who jacks up drug prices. We know who spends trillions on stock buybacks instead of higher wages. We know who busts unions. It is not our neighbors who may have a different political sign in their yard or a different bumper sticker on their car. It is the largest corporations, it is their unaccountable CEOs—from Facebook to Wells Fargo—and their allies in Washington.

Wall Street is all too happy to watch phony populists turn us against each other, as long as it means they get to keep exploiting workers and playing by a different set of rules.

For 4 years, we have had a President trying to convince people to blame their fellow Americans who may not look like them or worship like them, instead of blaming a system that rewards executives' stock portfolios when they lay off workers or when they cut their pay.

Divide to distract—that was the playbook. Divide to distract from all the ways he and his followers in Congress were funneling more wealth to the already wealthy and funneling more power to the already powerful.

But it did not work this time.

Last week, a record 80 million Americans rejected that division, the largest vote for any Presidential nominee in our Nation's history. Now we have to deliver results.

We have to take on big oil and other corporate polluters that have spent billions of dollars trying to convince people that climate change is an unsolvable problem, instead of a tremendous opportunity.

We have to end the corporate business model that treats workers, especially Black and Brown workers, as expendable, in a system that perpetuates systemic racism.

We have to break up the biggest banks and give that power to everyone else who has been denied a voice in our economy.

Our financial system should be a public good. It already is for big banks. We need to make it work for everyone else and create a better system centered around the dignity of work.

When work has dignity, hard work pays off for everyone, no matter who you are, no matter where you live, no matter what kind of work you do.

When work has dignity, everyone can afford housing and transportation, and they have power over their lives and their own money.

When work has dignity, we have a strong, growing middle class, and everyone—everyone—can reach it. Making that vision possible is the job of the Banking and Housing Committee.

We know we have great challenges. We are in a public health crisis, an economic crisis, and a climate crisis. Extraordinary times

call for us to aim higher and think bigger—to rise to meet this moment, to restore people’s faith in their Government.

Mr. Chairman, I look forward to coming together with Senators on both sides of the aisle, and with the new Administration, to get to work.

Thank you so much.

Chairman CRAPO. Thank you, Senator Brown.

We will now proceed to the testimony of our witnesses, and I will have you speak in the order I introduced you.

So, Vice Chairman Quarles, you may proceed.

STATEMENT OF RANDAL K. QUARLES, VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. QUARLES. Thank you, Chairman, thank you, Ranking Member Brown, thank you, Members of the Committee, for the opportunity to testify today on the Federal Reserve’s supervisory activities.

My last appearance, 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. 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.

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 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, and offsite examination activities. Importantly, 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 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 with their borrowers, was an important step toward this goal. Since then, working with our colleagues in other financial regulatory agencies, we have taken several others. These range from principles to guide COVID-related credit accommodations to 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.

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 by 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 7 months. It 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.

Chairman CRAPO. Thank you, Mr. Quarles.

Next, Acting Comptroller Brian Brooks.

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

Mr. BROOKS. Thank you, Chairman Crapo, Ranking Member Brown, and Members of the Committee. I appreciate the opportunity to update you on the OCC's work ensuring that Federal banks operate in a safe, sound, and fair manner and remain sources of strength for their communities.

Senator Crapo, I would like to congratulate you on your tenure chairing this Committee. I thank you for your leadership and per-

sonal thoughts as we worked together, and I look forward to working with your successor.

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 nearly historic high levels of capital and liquidity. Asset quality was strong, and the economy had enjoyed the longest expansion on record.

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 sustain economic activity. My testimony today will provide detail on the actions this agency has taken on that front.

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, in small business and consumer lending, and in the travel and hospitality sectors in particular.

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 will focus our supervisory efforts in the months ahead.

Prudent risk management today can avoid the need for more extreme loss mitigation tomorrow. Having said that, we also do see reasons for cautious optimism about the future based on strong third quarter GDP growth, continued 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 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.

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

The project is working to eliminate obstacles to credit for the 45 million Americans with no usable credit score, to expand affordable housing for those who cannot afford high downpayment requirements, and to reinvigorate minority banks that serve often neglected communities.

We have now kicked off regional REACH efforts, including one serving the greater Los Angeles area very recently, and we have hosted access to capital events in South Carolina and Colorado. I have been humbled by the momentum among the industry, community, and civil rights advocates and our staff here at the OCC.

Indeed, Project REACH has become a movement to tear down barriers so that all may pursue their American dreams.

Another reason for optimism comes from innovators themselves 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, and they will 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 evolved. We think this for several reasons.

First, the banking system is among our most strictly regulated and closely supervised industries. Those who fear innovation may harm consumers should consider the possibility that innovation might be safer in a supervised environment than it is under the currently largely unsupervised environment. The same is true for those focused on prudential risk.

Over the last decade, large market shares of lending and payments processing 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 and safe, sound, and fair ways within the Federal banking system to benefit consumers and businesses across the country.

Thank you again for the opportunity to testify today. I am proud to serve as the Acting Comptroller of the Currency and support the agency’s important mission. I look forward to your questions.

Chairman CRAPO. Thank you.

Next, FDIC Chair Jelena McWilliams.

STATEMENT OF JELENA McWILLIAMS, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. McWILLIAMS. Chairman Crapo, Ranking Member Brown, Members of the Committee, and staff, thank you for the opportunity to testify today. I hope that you and your families are staying healthy and safe.

When I testified before this Committee 6 months ago, we were confronting great uncertainty and volatility due to the COVID–19 pandemic and related Government shutdowns. 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. Banks of all sizes supported their customers and communities, including by originating nearly \$500 billion in PPP loans and accommodating more than \$2 trillion in new deposits over two quarters.

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. On both an aggregate and percentage basis, these capital levels were slightly higher than the quarter immediately preceding the pandemic.

To support the ability of banks to work constructively with their customers, the FDIC has taken meaningful actions to provide banks necessary flexibility while maintaining safety and soundness and consumer protection.

Today I will provide an update on five areas in which we have made significant progress: responding to economic risks related to COVID-19; enhancing our resolution readiness; supporting communities in need; fostering technology solutions and encouraging innovation; and finalizing outstanding rulemakings.

My written statement provides greater detail in each of these areas, but I would like to briefly touch on each of them, starting with our response 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. 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.

Over the past 6 months, we have taken additional regulatory and supervisory actions in support of these objectives and the economy. We continue to monitor conditions and receive feedback from supervised institutions, and we will consider additional guidance as appropriate.

On to our resolution readiness, 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 recognized that the absence of failures could not last forever, even before the pandemic. Accordingly, the FDIC improved our resolution-related capabilities by 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 should banks fail during the pandemic; coordinating with our international counterparts on cross-border resolution for global systemically important banks; carrying out targeted engagement and capabilities testing with select firms on an as-needed basis; regularly reviewing institution and financial industry data to inform FDIC resource management decisions and prepare for potential surge activities if necessary; and finalizing rules that will improve our resolution-related activities.

We have been mindful of also supporting communities in need during this time in particular. As the 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. As the Nation's deposit insurer and primary supervisor of community banks, including minority depository institutions, or MDIs, the FDIC plays an important role in helping these institutions meet the needs of their customers and communities.

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.

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 would 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.

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. 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.

Our recent biennial survey on household use of banking and financial services shows that individuals are increasingly moving to digital banking. As these trends continue, regulators should aim to foster the development of new technologies that improve the way banks operate and how they are able to serve their customers.

To enable this evolution, we established an office of innovation—FDiTech—and began working on several initiatives. Notably, we recently sought feedback on a ground-breaking approach to facilitate technology partnerships between banks and fintechs. 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. Reducing these barriers to innovation is particularly important for community banks. We look forward to reviewing recommendations from interested parties as we review next steps.

We also opened our first hack-a-thon to begin developing next-generation supervisory technologies that will streamline regulatory reporting, reduce regulatory costs, and improve the ability of regulators to quickly identify emerging risks at banks or across the financial system. Lessons learned in these events will not only increase the effectiveness of the FDIC, but they will also lay the foundation for streamlined tech integration in our Nation's banks.

We continue to focus our efforts on modernizing and improving the efficiency and resiliency of the financial system. We finalized two rules regarding Federal interest rate authority in Section 19 of the FDI Act, both of which codify existing FDIC guidance and bring clarity to the market. In addition, we engaged with our fellow regulators to address the Volcker Rule's overly restrictive covered fund provisions, modified requirements regarding the collection of initial margin from affiliates, and established a long-term liquidity metric for the largest banks.

Among upcoming actions, we intend to finalize two additional rules regarding broker deposits and industrial loan companies in the near future.

Chairman CRAPO. Madam, I am going to have to ask you to wrap up soon, if you would.

Ms. MCWILLIAMS. Thank you for the opportunity to testify today, and I look forward to your questions, and I apologize for going over my time.

Chairman CRAPO. No problem. Thank you.

Then, finally, Chairman Hood.

**STATEMENT OF RODNEY E. HOOD, CHAIRMAN, NATIONAL
CREDIT UNION ADMINISTRATION**

Mr. HOOD. Thank you. Good afternoon, Chairman Crapo, Ranking Member Brown, and Members of the Committee. Thank you for the opportunity to provide an update on the state of federally insured credit unions and the NCUA's efforts to assist them during the ongoing COVID-19 pandemic.

Our Nation's credit union system was well capitalized at the start of the pandemic and 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, to \$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 have issued 11 interagency statements and 20 guidance letters to the industry to date, helping credit unions to address emerging risk and 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 its 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 for 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 categories. Credit unions collectively extended \$8.4 billion in loans under the SBA's Paycheck Protection Program, 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 in the CARES Act has contributed greatly to bolstering the availability of liquidity in the 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. 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 & 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 toward this worthy endeavor.

In closing, I would like to thank the Committee again for the opportunity to appear before you today and discuss how the NCUA is working to protect our Nation's credit union system and the 122.4 million members, how they are all working to help them during this challenging time. I look forward to answering your questions. Thank you all for the opportunity to be here, and thank you, Chairman Crapo, for the leadership that you provide. It has been an absolute pleasure working with you, sir.

Thank you.

Chairman CRAPO. Thank you very much.

I will go with the first questioning. My first question is going to be directed to the Federal Reserve, the FDIC, and the OCC. But I would like you all to keep your responses to about 30 to 45 seconds because I want to get to a question for the NCUA as well.

I wrote to the Fed, the FDIC, the OCC, and the NCUA, and the CFPB, actually, in October, asking each of you to use your discretion to minimize the regulatory impact on banks and credit unions resulting from participation in the PPP. And I know that some of you have taken important actions in that regard.

I believe, however, that there is still a litany of rules that impose a burden on our institutions simply from passing asset-based regulatory thresholds based on their participation in PPP and other Government support.

The question I have first to Vice Chairman Quarles, Chairman McWilliams, and Acting Comptroller Brooks is: What additional areas can you use your discretion in to provide relief to banks that are subject to significantly more burdensome regulations simply

from participation in the PPP and that are eventually expected to revert in size eventually?

Mr. QUARLES. Well, I am happy to start with an answer to that question, Chairman. We do have some flexibility in our regulatory framework with respect to some of the measures that increase in stringency as banks increase in asset size to make temporary exceptions. We have done that, and we are continuing to look as to whether we should extend some of that relief.

With respect to some of the measures, we are not currently seeing that they are actually going to pose a problem. I think it is principally an issue for the smaller banks that are being pushed up over levels than the larger banks that might be being pushed into the next category or other. We are not seeing that with the larger banks that that is actually happening yet. But smaller banks could be pushed into some materially more difficult areas, and I think we need to look at what we can do there.

Mr. BROOKS. Chairman Crapo, I am happy to go next. I would begin by echoing Chairman McWilliams' statement in our opening remarks that at the most recent FDIC Board meeting, the members of the FDIC Board of Directors, myself included, approved a new position that will exclude those kinds of assets from audit requirements that are subject to asset size thresholds. And I would also say that the bank regulators on an interagency basis are currently working on a set of rules that would relieve for a period of time certain asset thresholds being tripped that trigger heightened scrutiny and heightened compliance requirements at different levels.

So just to orient Committee Members on this, there are a number of different regulatory requirements that kick in at \$500 million for certain things, \$600 million for certain other things, \$1 billion for other things, et cetera. And I think the direction of that discussion is something that will cap out at \$10 billion most likely based on current conversations. I think Vice Chairman Quarles has it exactly right that at larger levels, banks are fully capable of managing those risks, but it is small banks that have those difficulties. And I also think that there will be some time limitation on that, and there is discussion among the agencies as to what the appropriate temporary period of time is to provide that relief.

I would just close by saying that one thing that is important is that, on the one hand, we must accommodate the dislocations created by the COVID-19 pandemic situation, but at the same time it is important that those things be wound down just as soon as the pandemic ends, because it is important as supervisors that we have real visibility into the balance sheet risks created by those assets over time.

Chairman CRAPO. Thank you.

And, Chair McWilliams, we are down to about a minute, so you are going to get cheated on a little bit of time here, but please respond.

Ms. MCWILLIAMS. It is OK. I cheated a little bit earlier, so I will yield the time to Chairman Hood. I will just say that small banks have done a disproportionate amount of lending to their proportion of the banking industry share, so about 31 percent of PPP loans versus 15 percent of total assets. So it is only appropriate if you

look at these thresholds, as Comptroller Brooks mentioned, and accommodate them because they are truly temporary.

Chairman CRAPO. Thank you.

And, Chairman Hood, my specific question to you would be to see if you could focus on your comments that I heard and your evaluation of the PCA Framework and the net worth level issues in this context.

Mr. HOOD. Yes, sir, that really is important. One of the things that I wanted to note is that credit union shares are at an all-time high, as are loans. And in the current framework, there is now pressure on our credit unions to reduce their lending activities during this pandemic, and the last thing we need is for a third of Americans to not have access to credit during this time. So if we can provide any type of relief from prompt corrective action, it would certainly be greatly appreciated because what it does, it allows management to focus solely on meeting the needs of the member owners as opposed to any of the prompt corrective action frameworks that we have in place. I think if we can provide the relief on a temporary basis, safety and soundness will still be preserved. And, you are right, I did write about this in my April 29th response to you, so any relief that we can get would be greatly appreciated.

Chairman CRAPO. All right. Thank you very much.

Senator Brown.

Senator BROWN. Thank you, Mr. Chair.

To all four of you, you have all had an opportunity to serve your country at the highest levels. As this Administration winds down, I would like to thank you for your service, each of you.

But looking back over each of your terms, I do not think you have left your agencies, much less American families, communities, and small businesses, I do not think you have left them better off than when you took office. Each of you could have done so much more to actually improve Americans' lives, especially during these difficult last months. Instead, you have finalized the Wall Street wish list.

Vice Chairman Quarles, your job is one of the most crucial in our country when it comes to preventing another banking crisis. In 2006, you painted an optimistic picture of the economy, said you were offering "some perspectives on risks in the financial sector that have garnered a great deal of media attention." That sounds to me like an economist's version of shouting, "Fake news."

The 2008 crisis was very real. As far as I can tell, you learned nothing from it. Just like last time, you now insist that even though millions are struggling to stay in their jobs and stay in their houses, the economic future is bright because the stock market is up. Experts of all backgrounds have warned that the collapse in the real economy would inevitably cause enormous losses for banks. For almost a year, you have ignored the pleading from me and others, including former Fed Chairs, to stop bank dividends and protect the financial system.

I applaud the Fed's recent recognition that it needs to address racial inequality, but another lesson from 2008 is that a financial crisis would disproportionately destroy the wealth and opportunity for peoples of color. If the Fed is going to take the racial wealth

gap seriously, it must take financial stability seriously. You simply have not. Last week, 80 million voters rejected that thinking.

Chair McWilliams, the FDIC is supposed to ensure the viability of small banks, keeping your deposits safe so they can be put to work in our communities. Instead, you have gutted rules that were meant to keep mega banks from crashing the entire system, risking a repeat of the hundreds of community bank failures that happened in the last crisis. You approved a merger that created yet another too-big-to-fail bank that will likely muscle smaller community banks out of existence. You have attempted to force out experienced banking experts during an economic crisis. Most recently, you decided to distort data that proves millions of households do not have all the banking services they need. You did it by literally erasing those families from the FDIC report. Those underbanked households are many of the same people that would suffer if you got your way and gutted the Community Reinvestment Act.

Your tenure has certainly made life easier for big bank executives. I will give you that. But it is going to hurt the communities your agency is supposed to serve. Last week, 80 million voters rejected that thinking.

Acting Comptroller Brooks, OneWest, the bank that you and Secretary Mnuchin and Joseph Otting worked at was known, as you know, as a “foreclosure machine.” It makes no sense that the outgoing President handed the wheels of the economy to so many people who had a hand in crashing it in 2008. Even though you are running the OCC without the approval of the Senate, you have made sweeping changes to regulations to benefit the same corporations you used to lobby for. It is exactly this kind of self-dealing that has eroded so many Americans’ trust in their Government and the economy. And last week, 80 million American voters rejected that thinking.

And, Chair Hood, you are the only one on the panel I voted for for confirmation. The credit unions you regulate are often the only ones providing credit in Black and Brown communities and small towns in rural America. You are in a unique position to help Americans left out of our financial system, but instead of standing up for them, it seems like you are more focused on currying favor with the outgoing President and the photo ops that used to come along with it.

Last week, 80 million voters rejected that thinking. We now have an opportunity for the financial regulators to do what they should be doing to help. Elections have consequences. The Wall Street first attitude of the Trump administration is over. President-elect Biden—my colleagues on this Committee all know that he is the President-elect. Fear, I suppose, keeps them from saying it. President-elect Biden will have the opportunity to install watchdogs at these agencies who will put working families and their communities first and will give America confidence that their Government is on their side.

Mr. Chairman, thank you.

Chairman CRAPO. Thank you.

We will now turn to Senator Toomey.

Senator TOOMEY. Thank you very much, Mr. Chairman.

I would like to begin by congratulating each of our witnesses. I want to congratulate you on doing some outstanding work during an incredibly difficult time. Think about what we have been through as a country: the worst pandemic in 100 years, and the first time in the history of the Republic that Governments, our State Governments mostly but also to some degree the Federal Government, intentionally closed our economy. Never even been contemplated before much less actually take place.

So the economy was shut down. It was illegal to go to work, illegal to operate a business, and we all understand why. But what I find is absolutely extraordinary, as we look back on these last several months, is, despite that unprecedented catastrophic elimination almost of our economy for some period of time, yet almost no bank failures; and, in fact, the banking industry of America rose to the challenge, small banks and medium-sized banks, especially, providing credit to small businesses, medium-sized business consumers on a scale that most of us probably never imagined. The financial institutions weathered the storm because they were well regulated, well capitalized, read, able, and willing, and, in fact, they did respond to the need of their customers, the men and women who run the small businesses and employ so many millions of Americans. It is a remarkable success story.

And it leads me to a point I want to stress, which is part of what made that possible was the CARES Act and the 13(3) lending facilities. I want to just stress—and this is especially for Vice Chairman Quarles because this is relevant for the Fed. I believe that those facilities were a remarkable success by any reasonable measure. They were intended to restart the private lending of America's economy, to provide a backstop so that private capital could flow and businesses could borrow and, therefore, stay alive, keep their workers in place to the extent possible, and we would have an economy when we got to the other side.

Well, what has happened is as soon as those programs were authorized and set up, capital started flowing, actually like never before. The corporate market, corporate bond market, high-yield as well as high-quality credit, all-time record issuances. Bank lending off the charts. Liquidity was available and available very, very quickly. And that is a big part of the reason the economy has recovered as rapidly as it is. We all know it is not done yet. We have got work left to do. But how many economists anywhere in the world thought that we would have an unemployment rate below 7 percent at the end of October? People thought it was be 10 percent at the end of December, and it is not.

So this series of programs did their job. The private sector is providing the capital that is needed. It is now time to terminate these programs, which is exactly what was contemplated by the legislation and, frankly, to take a victory lap that we have gotten our economy back on track. It is not done yet, but it is definitely heading very much in the right direction.

A couple of quick questions. One, I just want to follow up on a question raised by the Chairman, and I guess this is—I will start with Vice Chairman Quarles. There was a discussion about some of the increased regulatory burden on banks, especially small- and medium-sized banks, for no reason other than the fact that they

really stepped up and responded in this crisis by providing credit. That swelled their balance sheets, and that has triggered, for those especially who crossed the \$10 billion threshold, a number of costly regulatory provisions, one of the most problematic of which is the Government-mandated price fixings of the interchange fees. So I would just urge you to consider ways in which you might ensure that we do not punish banks that really did exactly what their communities needed when they needed it.

I would like to ask also about the transition away from LIBOR, and I am mostly concerned about orphan contracts, those contracts that have existed in some cases for years and extend into the future, and they assume a LIBOR index is available for ongoing payments. What are we going to do about these orphan contracts, these contracts that are currently existing and they do not end until after the date on which we expect LIBOR to no longer be operative?

Mr. QUARLES. So I think we need to consider a mechanism that would allow those so-called legacy contracts, the great bulk of them, to mature on their existing basis without having to be renegotiated and shifted to a new rate, without allowing the continuation of the writing of new contracts during the period that that legacy is running off.

I think there are a variety of ways to do that. The banks have been discussing that. We have been discussing it with the banks. It is an international issue as well. We have been discussing it through the FSB and directly with the United Kingdom, which has a special responsibility for LIBOR. And I think that within the next month or two, we should have a plan to share that would address them.

Senator TOOMEY. So, you know, obviously LIBOR is a reference based on the eurodollar deposit market. There is a eurodollar deposit market, and it continues. Would it make sense to simply have a different mechanism for establishing what the offered side of that market is?

Mr. QUARLES. We could think about that. That could be a so-called synthetic LIBOR, and synthetic reference rates are something that the Bank of England and the FCA in the United Kingdom have thought about. I think in the United States, because of our different sort of litigation framework, I would want to think of other ways to try to address that issue before we move in that direction.

Senator TOOMEY. Thank you.

Mr. Chairman, I do not see a clock. Am I out of time?

Chairman CRAPO. Yes. You are actually a little over.

Senator TOOMEY. OK. I apologize and I will yield.

Chairman CRAPO. I will have to do better at my gaveling.

Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman, and thank you to the panelists for your testimony.

Vice Chairman Quarles, in a speech on September 23, 2020, you agreed with Chair Powell that it will take continuous support to stay in a robust recovery, which implies a second major COVID bill along the lines of the CARES Act. Is that still your position?

Mr. QUARLES. So I think I would say whether there is to be another round of CARES Act stimulus is ultimately, of course, a question for the Congress. As we look currently at the evolution of the economy, as Senator Toomey noted, the economy is recovering more robustly and more rapidly than we had expected in the spring, even than we expected a couple of months ago. Each time that we get new reports out, the numbers improve.

I think probably the most accurate thing to say would be that additional support would accelerate a recovery that is underway, but I would not want to say at this point that you would say that it was necessary.

Senator REED. Well, that is essentially what I think Chairman Powell has said and you said just not too long ago. One of the major aspects of the CARES Act was to support the State and local Government, and it is, I think, critical to do that because I hear from not only my Governor but Governors across the Nation that they are running into really difficult choices in terms of cutting public services and raising taxes. And without additional support, they will have to do that, which I do not think will help stimulate the economy or aid a recovery.

So what is your view of State and local assistance as we did in the CARES Act?

Mr. QUARLES. Well, I think you need to draw a distinction between the types of support that the Fed provides, which is backstop lending, which for many State and local Governments may not be the answer to their issues for them to acquire more debt. There are limits on the amount of indebtedness they can acquire for almost all of them. And our terms require that—you know, our policies require that they be made on certain terms from a decision that the Congress might make to extend additional fiscal support. And the latter would be something that, again, would be a decision that the Congress would make and would require quite different tools than the Federal Reserve has.

Senator REED. Right, it would complement what you are doing, and in addition to the additional resources, flexibility. Right now the States are prevented from using their resources to cover lost revenue, which for many States is the critical problem they have. And, in fact, the chief policy officer of the Chamber of Commerce pointed out that this has been a lead to really replacing the lost-time revenue with program tax increases, which is not usually considered to be stimulative. So do you think the flexibility is needed?

Mr. QUARLES. Again, with respect to the municipalities, I think that I can speak to what the Federal Reserve can do, and the decision to provide the broader range of support would be something for the Congress to debate and decide.

Senator REED. Mr. Chairman, do I have additional time? I have one more question for Chairman McWilliams.

Chairman CRAPO. You have 50 seconds.

Senator REED. Thank you very much.

Chairman McWilliams, in 50 seconds, this might be more of a final point by me. We are facing a housing tsunami. The National Council of State Housing Agencies indicated that U.S. renters will owe up to \$34 billion in past-due rent by January, increasing eviction filings, imposing punishing financial hardship on millions in

just a few months. We could have in January—and that is not too far away—thousands, hundreds of thousands of people being evicted or foreclosed; and in the midst of a pandemic where sleeping five in a bedroom is not the best medical advice I think doctors would give, that could happen, probably, and indeed I think we have to do something. So I would hope that you and your colleagues in the housing community will be thinking hard about supporting efforts to provide financial relief to these renters. Eventually, it will hit the banks because, as they foreclose on the mom-and-pop landlords, they will have a lot of property on their hands which might not be very valuable. So I would hope you would do that.

Respecting the Chairman and his graciousness, thank you very much, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Reed.

Senator Scott.

Senator SCOTT. Thank you, Mr. Chairman, and thank you to the panel for being here with us this afternoon.

I will start with Acting Comptroller Brooks and Chairman Hood. Since this Committee's last oversight hearing, your agencies have launched initiatives aimed at promoting broader financial inclusion: Project REACH at the OCC and the ACCESS initiative at NCUA. As someone who spent much of my time in Congress and now in the Senate working to identify and reduce barriers to economic mobility and opportunity and to expand access to credit and capital, especially for underserved communities, I was deeply encouraged by these initiatives. I would love to have an update both on REACH as well as ACCESS. Perhaps, Mr. Brooks?

Mr. BROOKS. Well, thank you, Senator Scott, and thank you for your continued engagement on these issues. I very much enjoyed our event together in South Carolina where we looked at the intersection between Project REACH, the CRA, and your opportunity zones bill. So I think this was a terrific dialogue.

On Project REACH, I think most of you are aware that Project REACH has three major components at the national level. One is to convene bankers, civil rights groups, and tech executives around the idea of building a synthetic credit score for the 45 million Americans who do not have one. The reason that matters is that in America, the principal way that most families build wealth generationally is through home ownership, and, you know, it is hard to buy a house in this country without a mortgage, and you cannot get a mortgage without a credit score.

So the 45 million so-called credit invisibles are hugely disproportionately Black and Hispanic, so this is a major civil rights issue for our time. And yet it turns out that giving those people credit for their rent payments, their utility payments, and their cash-flows and their bank accounts, which most of them have, is relatively easily doable. So I think that we are not very far away from an announcement of a version 1.0 of a new kind of credit score, working closely with the Big Three credit bureaus and the companies I just mentioned, to allow those people the opportunity to be considered for home mortgages. That will be a game changer when that becomes available, and I think that will be available this year.

The second piece has to do with the 20-percent downpayment requirement that most Americans face in buying houses, and, again, the percentage of people who inherit money to make a 20-percent downpayment is disproportionately favoring, you know, Whites and Asians and disproportionately disfavoring Blacks and Hispanics who more often than others did not inherit money generationally and, thus, have a very hard time meeting that threshold.

Downpayment assistance programs have offered some support for that, but we think that a more radical examination of the system is required, and various participants in Project REACH have talked about different ways of closing the downpayment gap. One of those ways has to do with the possibility of equity financing as well as debt financing for home ownership, and there are a lot of people who are very enthusiastic about the ability of drawing new capital sources into the housing market for that. So these are all very good.

One of the most important things we are working on here is reinvigorating the commitment of large banks to support minority depository institutions in their communities, so the other piece in Project REACH we expect to be announced very shortly is the Project REACH MDI Pledge, in which big banks will commit not only to supporting MDIs financially, but also through engaging in executive training programs and rotational programs and real business partnerships designed to make MDIs successful, not just to preserve their existence but to make them successful in their communities. And the reason that matters a lot is that MDIs are the trust builders in certain communities. They are the reason why many African Americans who do not feel comfortable, for example, interacting with big banks who they may have felt scammed them in the past do feel comfortable approaching MDIs in their own communities, and that is an important entry point into the banking system.

Senator SCOTT. Thank you very much.

Chair Hood?

Mr. HOOD. Thank you, Senator Scott. Since becoming the Chairman of NCUA, I have long advocated that financial inclusion is indeed the civil rights issue of our generation. To that end, I was very pleased to work with my agency colleagues to recently launch ACCESS, that is, Advancing Communities through Credit, Education, Stability, & Support. The first piece is credit. We are going to need to continue to have small-dollar loan products when we live in a society where 40 percent of American households could not come up with \$400 in an emergency. That percentage grows to 60 percent in communities of color and, sadly, 90 percent in disabled communities. So we want to work to ensure that individuals will have access to low-dollar amounts, small-dollar loans. I am pleased that credit unions today have made 171,000 loans that are really helping provide small-dollar loans, but we want to do more, and we especially want to do more in minority communities.

Another piece is education. How do we provide the educational coaching and help and financial well-being so folks cannot just get into the credit system, but how do they remain in it sustainably? So we are working with groups such as Operation HOPE and oth-

ers who can really help propel individuals into the mainstream economy.

The next piece is stability. Mr. Brooks just talked about minority depositories. We at NCUA supervise 509 MDIs. We want to do more than strengthen them. We want to make sure that they are empowered to succeed and touching communities of color who traditionally have been left on the margins of economic success. So we are continuing to provide mentoring relationships. We are providing technical assistance and grants. We want to even encourage them to work in opportunity zones that you champion. In addition to stability with MDIs, we also want to support our low-income designated credit unions and CDFIs as well because they are all on the front line when it comes to providing mainstream financial access.

The last piece is support. Support looks for us in the chance of looking at employment opportunities. If people are going to have mainstream success, they are going to need to have jobs. So we have implemented the Second Chance Initiative where individuals who may have had nonviolent, noncriminal offenses can now work in our credit unions. And we are also looking at a pipeline for the future where we are providing opportunities for students of colors and others to enter in the financial services industry. So that, sir, is Operation ACCESS. Thank you.

Senator SCOTT. Thank you. Mr. Chairman, I know that I am about a minute over my time. I will just close with these comments. I am going to submit some more questions for the record to Chairwoman McWilliams as well as Vice Chairman Quarles.

Mr. Brooks, thank you for your approach in coming to Charleston and being willing to go across this country promoting ways to help the credit invisible as well as to lower the challenges or hurdles around downpayments. Your work has been, frankly, some of the most nonpartisan—not bipartisan but nonpartisan work I have been a part of. Thank you very much.

Mr. BROOKS. Thank you, Senator.

Chairman CRAPO. Thank you.

Senator MENENDEZ.

Senator MENENDEZ. Thank you, Chairman.

Earlier this year, the House Select Subcommittee on the Coronavirus Crisis found that the Treasury Department privately encouraged lenders to prioritize existing customers when issuing Paycheck Protection Program loans, leaving many minority-owned small businesses without access to important Federal aid.

So, Comptroller Brooks and Chair McWilliams, were you aware that Treasury privately encouraged banks to focus on their PPP lending to existing customers? A simple yes or no would do.

Mr. BROOKS. So, Senator Menendez, thank you for that question. I was not aware that there was such a thing, and I am not aware today. I do know that there were some issues around Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance which did lead some banks to make those judgments themselves because they had already vetted their existing customers. But I am not aware of what you suggest just now.

Ms. MCWILLIAMS. Likewise, Senator Menendez, I was not aware, but I know that initially banks were—we were asking them to

originate these loans quickly to get into the economy so that people can get paid and make their payments, and as a result of that, reaching out to existing customers alleviated some of the burdensome—

Senator MENENDEZ. You said you did not know. Neither of you knew. But the head of the American Banking Association told its board of directors, “Treasury would like for banks to go to their existing customer base.” And JPMorgan corroborate this account, explaining, “From early on there was an understanding from Treasury that banks would be working with existing clients.”

So you must have known that at least this was unofficial guidance. Did you push back in that regard?

Mr. BROOKS. So, Senator Menendez, maybe I can start with an answer to that. So early on in the PPP rollout, one of the things that we identified across our banks was not that they were favoring their existing customers; it was that they were having a hard time doing Know Your Customer, as I say, another compliance for new clients in the door in a rapid response framework. So one of the things we did at the OCC is we convened a set of listening sessions with banks who were having that difficulty and fintechs that had adopted various Know Your Customer and customer identity verification tools to allow them to quickly originate loans to people that were not already in their system.

We know anecdotally that that listening session had some results, that there were some partnerships that resulted in that, and particularly in the mid-size and community bank group inside of the OCC, they were able to ramp up new customer support.

Ms. MCWILLIAMS. And, Senator Menendez, from the FDIC, community banks were proactively reaching their customers, and to the extent that they had new inquiries from new customers, they had to go through the due diligence that, frankly, the agency is required—

Senator MENENDEZ. Did either you or the FDIC or the OCC encourage banks to extent PPP lending beyond their customer base?

Mr. BROOKS. So, Senator, speaking for the OCC, absolutely. That was the purpose of those listening sessions that I mentioned. They were attended by—

Senator MENENDEZ. Beyond listening, did you urge them to extend beyond their customer base?

Mr. BROOKS. Yes, the whole announced point of the listening session was to help them overcome the hurdles to get to new customers.

Senator MENENDEZ. Well, I would just simply say many minority-owned small businesses do not have existing banking relationships, and Treasury’s decision to encourage banks to prioritize PPP loans to their existing customers and from my perspective both the FDIC and OCC inaction has had devastating consequences on our Nation’s minority-owned small businesses. Limiting PPP loans to banking customers left minority small businesses out of \$670 billion of Federal aid. Now 41 percent of Black-owned small businesses, 32 percent of Latino-owned small businesses are permanently closed because of the pandemic. This was avoidable. It is avoidable. And it is a shame that that is, in fact, what took place.

Let me ask you, Comptroller Brooks, in May I asked former Comptroller Otting about your agency's work on the Community Reinvestment Act. At the time Mr. Otting stated that despite the pandemic and evidence that the PPP lending was failing to serve minority communities, the OCC should accelerate its work on implementing the CRA rule, a rule that most in the civil rights community oppose.

Since then, the Federal Reserve issued its own Advanced Notice of Proposed Rulemaking that invites comments from stakeholders on how the CRA can be strengthened to meet its core purposes of reinvesting in low-income communities.

When the Fed issued this ANPR, you stated, "I have told the Fed that if they get good comments in response to their rulemaking, we are not beyond the prospect of finding ways of improving it even more." But can you clarify what exactly you meant by that? It seems to me that the Fed is likely going to receive comments from the civil rights community and other comments that track what they have stated in response to your rulemaking. The OCC disregarded a lot of that at the time. What would lead you to change your mind now?

Mr. BROOKS. Well, Senator Menendez, the first thing I would say is that the Fed's ANPR is so similar to the OCC's final rule in its substantive elements as to be almost indistinguishable in terms of their change in geographic assessment areas, their inclusion of Native American country, small family farms, and other things that were originated in the OCC's rule. We frankly took it as imitation being the sincerest form of flattery when it came to their ANPR.

The main difference between the Fed's ANPR and the OCC's rule is that the Fed appears to continue to prefer subjective and discretionary performance assessments; whereas, our view is these things should be more objective and predictable over time. But what I really meant was I think both the Fed and the OCC recognized that the status quo is simply untenable. The status quo had been tied to bank branches as the only areas incentivized for lending and investment, and banks have pulled more than 10,000 branches out of minority communities over the last 25 years. So our basic view was we need to make the system better, and if there is a way of making it still better next year, we are happy to do that. But letting it sit for another 2 years in the current status quo was, in our view, an unacceptable option.

Senator MENENDEZ. I think it is always telling that the entire civil rights community has a much different point of view, and if anyone is an advocate for these people, it is them.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman.

First of all, to all of our panelists, thank you very much for participating today.

Vice Chairman Quarles, as I said in the past, we should not be making it harder than necessary for banks to do their jobs considering that we are really relying on the banks to lift our economy out of the COVID slump. As we look ahead to the end of 2020, however, I am worried that unnecessary regulatory burdens will only

increase. The Fed's actions to temporarily exclude low- and no-risk assets from the supplemental leverage ratio made sense given the flight to cash that took place at the onset of the coronavirus pandemic. The G-SIB surcharge, on the other hand, is said to be calculated at the end of the year but has not been adjusted to take the same considerations into account. I am concerned that not providing a similar adjustment for the G-SIB surcharge could prevent institutions that have the broadest and deepest reach into our economy from doing their jobs when we need their help the most.

Would you agree with me that it would make sense to extend the low-risk asset exclusion from the supplemental leverage ratio to the G-SIB surcharge since the G-SIB surcharge calculations are imminent?

Mr. QUARLES. So I think there is a logical analogy there. I think what we have seen with respect to the G-SIB surcharge calculations is that we are not hearing from the large firms that are affected by them, that the changes in their balance sheet over the period of the COVID event are leading them to possibly being pushed up into a higher bucket or leading them to contract activity in a way that we would not want at a time when we want the most support for the real economy so that that does not happen.

In general, my view on the G-SIB surcharge is—you know, we calculated our G-SIB surcharge at the high level, and as we look at the final implementation of the Basel III framework, which I intend to accomplish over the course of the next year, we should then look at the overall package of measures that were put in place before these last measures that we will implement—that includes the G-SIB surcharge and many others—and ensure that they are all calibrated so that the level of capital in the system remains roughly the same as we put these new measures in. I think that is the right time to look at the calibration of the G-SIB surcharge.

If we were hearing from a lot of firms that there was a real problem that was arising, as we were hearing with respect to the supplemental leverage ratio, that might be a different story. But at the moment we are not.

Senator ROUNDS. It will be interesting to see what their thoughts are after today's hearing as to whether or not they want to make contact with you. Thank you for that.

Chairman McWilliams, last month the FDIC released its latest annual survey of the household use of banking and financial services. I was very surprised to see that there was actually an increase in the percentage of American Indian households that are unbanked from 2015 to 2019 and that the percentage of Native American households that are unbanked is roughly 10 times as high as a household making the average income from a family in South Dakota.

Given the critical importance that banking services will have on our economy recovery, particularly in vulnerable areas like Native American reservations, which not only are they people of color but literally you are talking about living on reservations as well, providing ample access to credit is going to be critical in the weeks and the months ahead.

What more can we be doing to help reduce the number of unbanked and underbanked Native Americans in the near future but also long term?

Ms. MCWILLIAMS. Thank you, Senator Rounds, for that question, and it is frankly one of those issues that have been very close to my heart in figuring out how can we get more people to become a part of the banking system, recognizing that the Native American community has been particularly impacted in this area.

I think this is where, frankly, innovation and encouraging banks to work with fintechs in providing the path for them to do so in a responsible way with respect to consumer protection and safety and soundness is going to be pivotal to be able to ensure that those communities have access to credit, access to banking accounts. Also, trying to help the minority depository institutions, especially Native American MDIs that serve those areas in particular, and specifically to have access to capital, and I mentioned in my opening statement we are creating a somewhat unprecedented fund that will be managed by an outside party that others can invest in, and that fund would go to help MDIs, and my hope would be quite a bit of help would go to the Native American MDIs, minority depository institutions, to offer banking products.

So we are heavily focused on this, and I am happy to sit down with you and brief you on some of the other efforts.

Senator ROUNDS. Thank you. And, Mr. Chairman, I suspect that my time has expired.

Chairman CRAPO. It just did.

Senator ROUNDS. All right. Very good. Thank you, Mr. Chairman. Thank you for your response.

Chairman CRAPO. Senator Tester.

Senator TESTER. Yes, thank you, Mr. Chairman and Ranking Member Brown, and I thank all the folks who are here testifying today. I appreciate it very much.

I am going to start with you, Vice Chairman Quarles. I want to go back to a question that Jack Reed had asked you, and it revolves around the need for additional dollars in the economy, what Powell had said, what you had agreed with that statement awhile back. And I just want to give you an opportunity to clarify, and I want to preface this question by saying we have 125,000 infections a day, which is an incredible number. Experts are saying it will be 200,000 a day by the end of this month. Hospitals are full. They are full all over the place. In fact, my wife had major surgery last week. Her recovery was in the pediatric unit, and I said, "Why is my wife in the pediatric unit?" And they said, "Because the hospital is full of COVID patients." This was the only bed they had.

So my question is that we have got schools, both K-12, university units, we have got municipalities, we have got working families, we have got small businesses. There are a number of folks out there that are still in a world of hurt. I had a doctor tell me 2 weeks ago, 3 weeks ago, that January, February, and March may be the toughest months this Nation has ever endured, which is a hell of a statement. So tell me what—if you really meant that, that there is not any need for any additional stimulus? Or what exactly did you say?

Mr. QUARLES. So I think that the—well, Senator Reed’s question was, I think, particularly in the context of the municipal facilities and what could be done there. I do think that we are with each—I would not want to understate at all the degree to which many people in the country continue to struggle as a result of the COVID event. The question that I was trying to respond to was with regard to the type of support that would be appropriate for them and drawing the distinction between is this support—

Senator TESTER. So let me cut to this, Randal. My question—and it is different than Senator Reed’s—is: Do you think that there needs to be another stimulus package generally speaking focused on the economy of this country, whether it is municipalities, whether it is schools, whether it is small business, whether it is unemployed families? Do you think there needs to be another package?

Mr. QUARLES. So, again, I think that as a central banker I should leave those decisions to the Congress. I do not think—

Senator TESTER. Come on, come on, come on, come on. A month ago you gave us your two bits on this deal, and now you are not. I voted for you, OK? I thought you would be—I thought you would not have politics into this. It seems to me that since the election there is a different point of view now, and that drives me crazy.

Mr. QUARLES. No, it is a result of the fact that the economy is recovering faster than any of us expected.

Senator TESTER. OK. OK, I got it. So you guys do not—it is from the very get-go on this pandemic, the economy has followed this pandemic right down the line, and we do not have to shut down any businesses. I guarantee you when people—when the hospitals are full and people are dying in record numbers, that information gets out there, and people do not go out period. I have got two brothers that are older than I am that go out very, very seldom because of this pandemic.

So my question is—and I guess your answer is no, we do not need any additional money infused in the economy, and if it is, that is fine.

Mr. QUARLES. Senator, my answer is that as a central banker I should not try to subsume the role of the Congress. I think the Fed facilities are limited in what it is that they can do.

Senator TESTER. Vice Chairman Powell, I want to try to be fair, but—I mean Vice Chairman Quarles—but when Powell said it, you said, “I agree.” Now you are saying, “I do not want to make a statement on this.” And you are a central banker, and, in fact, you do have major impacts on the economy, and decisions you make and what you advocate for, actually people like me actually listen to you. And you are saying, “That is not my problem anymore. There will be a new Administration in 2 or 3 months, so what the heck, what happens happens.” Is that right?

Mr. QUARLES. No, that really is not what I am saying, Senator.

Senator TESTER. All right. But I certainly did not get an answer to the question of whether we need more money into the economy or not.

Thank you, Mr. Chairman, and I have got to tell you I am very disappointed in that perspective considering it was totally different a few months ago.

Chairman CRAPO. Thank you.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. Can you hear me OK?

Chairman CRAPO. Yes.

Senator KENNEDY. OK. Let me know, Mike, when my time is getting close.

Mr. Quarles, what percentage of small- and medium-sized American businesses in your judgment are losing money right now?

Mr. QUARLES. I do not know that percentage, Senator. I could find it out.

Senator KENNEDY. I am not trying to trick you. I am just trying to get your sense of the economy. Do you think it is more than half? Less than half? What is your hunch?

Mr. QUARLES. The number of businesses that are losing money right now I would—

Senator KENNEDY. Small- and medium-sized—

Mr. QUARLES.—say small businesses is probably less than half, but I would want to get an accurate answer for you. I do not know the answer to that statement.

Senator KENNEDY. Yes, I read—the Economist had a piece yesterday saying that as best they forecast, it is between a third and 40 percent. Now, these are small- and medium-sized businesses. But that is most businesses in America in terms of jobs.

What is your sense of the economy in terms of whether we have recovered from the coronavirus yet, economically of course, and how long it is going to take us to get back to our pre-virus GDP?

Mr. QUARLES. No, we obviously have not recovered. Unemployment rates are still very elevated, and I may have over-obsessed on the question of whether it was half or not. There clearly is a lot of distress among small businesses. There is a great deal more recovery to be done in the country. The length of time that that would take I think is hard to tell. It is dependent on perceptions of the course of the virus. It is dependent—

Senator KENNEDY. Randy, what is your gut? I mean, are we going to—at this time next year will we have recovered to our pre-coronavirus GDP? Or do you think it is going to take longer? What is your gut?

Mr. QUARLES. No, my projection, for what it is worth, is that it would take longer than a year. I would expect us to be toward our pre-COVID levels 2022, maybe early 2023.

Senator KENNEDY. If we did more stimulus and it was targeted in the right way—let us suppose we did more PPP—would that help? Could we shorten the amount of time?

Mr. QUARLES. It would accelerate the speed of the economic recovery. I think that is unquestionable.

Senator KENNEDY. OK. Let me talk to you just for a few minutes about the Treasury market. It almost froze up, did it not?

Mr. QUARLES. For a period there in March, yes, there was severe distress. It almost froze up. That is fair to say.

Senator KENNEDY. I mean, people throughout the world were actually trying to dump Treasuries in exchange for dollars, were they not?

Mr. QUARLES. Yes. There was spilling in many different quarters and all around the world.

Senator KENNEDY. So when we had the meltdown in 2008–9, everybody was running to Treasurys as a safe haven. This time they did not even want Treasurys. They wanted dollars, cash. Am I right?

Mr. QUARLES. That is correct.

Senator KENNEDY. OK. If you want to unload Treasurys or buy them, you have got to go through a primary dealer, do you not? Is the proper term “primary dealer” or “primary broker”?

Mr. QUARLES. Primary dealers are—

Senator KENNEDY. Primary dealer.

Mr. QUARLES. Yes, sort of the central dealers in the Treasury market. I mean, Treasury securities can be sold and cash can be obtained from Treasury securities in other ways, but they are critical.

Senator KENNEDY. OK. How many primary dealers do we have?

Mr. QUARLES. It is about 29.

Senator KENNEDY. OK. Why do we have to go through primary dealers? Why don’t we set up a system—I mean, the primary dealers were part of the problem, which is why you guys had to step in.

Chairman CRAPO. And you have about 30 seconds, Senator Kennedy.

Senator KENNEDY. Thank you. Why don’t we set up a system where we do not use primary dealers, where people can trade with each other? Mr. Quarles?

Chairman CRAPO. You know, we had a little bit of trouble with Mr. Quarles’ audio at the beginning, and it looks like we may have just lost him again.

Senator KENNEDY. Can I have my time back?

Chairman CRAPO. You can have 30 seconds, Senator Kennedy.

Senator KENNEDY. That is all I need.

Chairman CRAPO. But not for Mr. Quarles right now, unless you want to speak to him, yes.

Senator KENNEDY. He is gone, right?

Chairman CRAPO. Yes. He may be able to hear us.

Senator KENNEDY. Well, that is pretty convenient.

[Laughter.]

Senator KENNEDY. You hit the old “disappear” button. Well played there, Randy.

Let me ask another one of the people, why do we use all these primary dealers. Why don’t we just set up a system where people could trade with each other? Whomever.

Chairman CRAPO. Oh, he is back.

Mr. QUARLES. I am back. Did that fail again? No, I am back. And that was not strategic. I do want to answer the question. I think it is fair, Senator, for us to look at secondary market trading of Treasurys going forward. That is a lesson learned, and we have an interagency working group put together to look at alternatives, just as your question would suggest.

Senator KENNEDY. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Kennedy.

Next is Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. And thank you to our witnesses for being here.

So all of you are in charge of making sure that regulating the banks and credit unions to make sure that when the economy is in serious trouble, our financial system is going to be able to weather the storm. So Americans' jobs and homes and livelihoods depend on your getting this right.

One way the Federal Reserve monitors the soundness of the financial system is to conduct stress tests on the largest banks to see if they are going to be able to handle a severe down turn.

Now, in the most recent analysis, which was 5 months ago, the Fed noted that firms' capital forecasts "tend to be strongly dependent on the assumption that there will be additional rounds of economic stimulus." In other words, banks are in good shape if the Federal Government passes a strong stimulus bill to help the people in businesses that are struggling because of the pandemic.

Vice Chairman Quarles, the Fed's analysis was released in June. Did the assumption that was built into the stress test occur? Has Congress passed any additional economic stimulus since June?

Mr. QUARLES. Senator, the answer to that is no, the Congress—

Senator WARREN. OK. So there has been no economic stimulus in the 5 months since you released that report saying how much the banks needed the economic stimulus.

Now, 6 months ago, however, House Democrats passed a comprehensive relief bill, and for 6 months Mitch McConnell has refused to let the Senate vote on that bill. In the meantime, unemployment benefits ran out, evictions resumed, State budgets cratered, and Black and Brown workers paid the highest price.

So I am worried because this creates a very dangerous cycle. When families and small businesses lose Federal help and they cannot pay their loans, then the banks and then our entire financial system are at risk. And sure enough, the banks are now reporting that they anticipate higher loan default rates.

So, Vice Chairman Quarles, without stimulus, do the banks and the financial system run more risk? Hello? Have we lost the Vice Chair?

Chairman CRAPO. It sounds like we have lost the Vice Chair again. I am sorry, Senator Warren.

Senator WARREN. So this is something that only works for the Vice Chair, I mean the Fed here.

Chairman CRAPO. Actually, he is the only one we have had the problem with so far. It was there at the beginning of the hearing. We actually—

Senator WARREN. I am not suggesting this was strategic. I am just asking—Mr. Chairman, do you want to let somebody else go and have me finish my question when we get the Vice Chair back? What would you like to do?

Chairman CRAPO. Well, the next on my list is Senator Schatz. Do you have questions for some other than Mr. Quarles?

Senator SCHATZ. All of my questions are for Mr. Quarles.

Chairman CRAPO. OK. Well, then, next after you is Senator Van Hollen. He may not be with us. He is signed in. Senator Cortez Masto—wait, Senator Van Hollen is here.

Senator VAN HOLLEN. I am here. The good news is I am here, Mr. Chairman. The bad news is I also have some questions for Mr. Quarles.

Chairman CRAPO. OK. We are doing our best to get it back up with Mr. Quarles. Senator Jones?

Well, I do not know what to do, folks, because—

Senator CORTEZ MASTO. Actually, Mr. Chairman, I do have some questions for other—

Chairman CRAPO. Oh, yes. Senator Cortez Masto, you can help us out here, hopefully.

Senator CORTEZ MASTO. Thank you. Thank you, everyone. I so appreciate the opportunity.

Let me start with Acting Comptroller Brooks with the true lender rule. Do you still intend to move forward with the true lender rule?

Mr. BROOKS. Thank you, Senator Cortez Masto. We do. As you know, we have just finalized that rule, and, you know, we believe that it is important for a wide variety of reasons, the most important of which perhaps is solving the age-old problem of rent a charter, where banks were disclaiming responsibility for loans they originated. One of the purposes of the true lender rule is to focus compliance obligations where it belongs, which is the bank that holds itself out as the lender.

Senator CORTEZ MASTO. So can I ask you then why are there— if I am not mistaken, there are 13 national consumer and civil rights groups and more than 100 groups submitted comment letters that your proposed rule would facilitate fraudulent predatory rent-a-bank schemes and otherwise undercutting the interest rates that States have set on some of these loans. How do you address that?

Mr. BROOKS. Well, there are a lot of adjectives and adverbs in that accusation to unpack, but I think there are two main things going on. There is the issue of interest rates, and then there is the issue of all of the other consumer protections out there.

When it comes to interest rates, the Congress and the Supreme Court decided in the late 1970s and early 1980s that it was a good thing for the economy—and this was a broad bipartisan consensus at that time—to allow both national banks and State banks to export their home-State interest rates to other States. The reason for that was, if you think back to that era, there was rampant inflation, and in many States it was essentially illegal to get a loan because the market rate of money was higher than the legal rate of money. And so that was one of the ways that we got through the financial crisis of the late 1970s, was that kind of decision.

All that is going on in our true lender rule is the idea that banks can originate these loans and they can sell those loans on the secondary market to nonbanks, as they always have, really, without questioning the legality of the banks' original interest rate exportation authority.

The innovation of true lender is to make sure that somebody is responsible for the consumer protections associated with that loan, and in the last 25 years, nobody has been responsible. It has been an issue of sort of both sides pointing at each other.

So in our rule, we facilitate banks doing what they have had the authority to do since 1978 in the Marquette case, and we have

made clear that if they enter into these partnerships, they are responsible for the fair lending law compliance, the disclosure and truth-in-lending law compliance, the UDAP obligations, and every other thing that neither the banks nor their partners have taken accountability for in the past.

So the point is to bring more credit to more people and to create accountability where there was none.

Senator CORTEZ MASTO. I appreciate that. I would ask, though, that you continue to watch this, because as a former Attorney General (AG)—and I already noticed now there are several AG lawsuits because you have rent-a-bank lenders like Elevate that has just been sued by the AG of the District of Columbia; you have LoanMart, which has been sued by California, and others utilizing this opportunity to circumvent the interest rate paths that have been set by 45 States, including the District of Columbia, which are in essence predatory loans with higher interest rates.

So I would ask that you consider to take a look at that and follow that as this moves forward, because the biggest concern, particularly now during COVID-19, when so many people are struggling, they are going to look for these loans, and there are going to be predators out there, and it would be the worst thing to see that your new rule has opened the door for those types of predatory loans, so I would ask you to consider to take a look at that.

Mr. BROOKS. And, Senator, I would just say absolutely. The good news about the rule is it now gives us authority to police those from the bank side.

Senator CORTEZ MASTO. Right. Thank you.

Let me jump back here and talk a little bit about Troubled debt restructuring, because I know in some parts of Nevada, and really across the country, borrowers have begun repaying their loans. But in Las Vegas and other places reliant on hospitality tourism, business owners still do not have the income to pay their loans in full every month.

So let me ask, Chair Hood, do you think some credit unions and banks are at risk of failure due to the inability of some of their commercial real estate and mortgage borrowers to pay their loans on time and in full?

Mr. HOOD. Well, credit unions, Senator, have a long history of really helping their member-owners during times of adversity. In fact, the credit union system grew following the Great Depression, so based on the data we have to date, credit unions have entered into the COVID with very strong capital, well above our statutory requirement. Liquidity is strong. And, in fact, from what we are seeing in looking at call report data, they are doing relatively well in the sense that they are continuing to provide forbearances. In fact, Senator, credit unions have already provided 1.7 million loan forbearances for an aggregate amount of \$55 billion, so almost 50 percent of our credit unions are all providing some type of forbearance.

Based on the data we have, we do believe that we have the tools to really keep the credit union system safe and sound. If there is one ask I would have, it is working with you and your Committee to extend the Central Liquidity Facility in the CARES Act. As you know, liquidity is a major pillar of our industry. While we have

solid liquidity now, I think in the future, because we do not know what the future portends, it would be nice to know that we do have that extension beyond December 31st of this year, ma'am. But I do think the credit unions are positioned to continue what they have always done, and that is providing member service.

Senator CORTEZ MASTO. Thank you. Thank you all. I notice my time is up.

Chairman CRAPO. OK. Thank you. And I believe that we have been able—we have been trying to hook up with Vice Chair Quarles by phone. Do we have you by phone, Mr. Quarles?

Mr. QUARLES. Yes, if you can hear me. I am so sorry.

Chairman CRAPO. Yes, we can hear you. So, Elizabeth, we can go back to you now. We will not have his picture, but we have him and his voice. And I do not know where you were—

Senator WARREN. It is OK. I will try to pick up where we were.

So what we were talking about is that the Fed conducted stress tests on the largest financial institutions, said that the financial institutions are healthy, but that the capital forecasts tend to be strongly dependent on the assumption that there will be additional rounds of economic stimulus.

Then we established—that was 5 months ago—there have been no additional rounds of economic stimulus, and in the meantime, we have seen a lot of negative economic indicators, and that indeed the banks are now saying that they anticipate higher default rates.

So the question I had been asking, Vice Chair Quarles, is: Without stimulus, do these big banks and ultimately the financial system run more risk?

Mr. QUARLES. So I should note that, as you noted in your original question, the banks' projections themselves assume stimulus, but our stress tests have not assumed any stimulus. We want to ensure that the stress tests that we—

Senator WARREN. Well, fair enough. Look, but that is not the question I am asking you, and also, the question about how much capital they have got obviously goes to the heart of your stress test. And you said right there in the stress test that the projections on capital depend on there being a stimulus. And, look, families need help. They have needed it all summer while Mitch McConnell has stubbornly crossed his arms and refused to let us vote. And now Senate Republicans are doing even more damage to our economy if they do not put a relief bill out that is big enough to get the job done and up for a vote.

So, you know, this is a problem, obviously, at the Senate level, but the Fed itself is not powerless as well. You can act right now. You are allowing the big banks to continue to shovel billions of dollars out the door in dividends, money that could be used to help survive a historic downturn. You could stop this outflow of money right now.

So at what point, Mr. Vice Chairman, will the Fed actually do its job and suspend all dividend payments?

Mr. QUARLES. Bank capital ratios have been rising over the last 6 months, Senator, and—

Senator WARREN. That is not the question I asked you, Governor Quarles. What I asked you was: What data are you going to need to see in order to actually take action here? We are watching a

downturn in this economy. The stress tests specifically say they are based on the assumption there was going to be stimulus. Mitch McConnell has refused to let us get a stimulus. So I am asking about the billions of dollars that the banks are still pushing out the door in dividends because ultimately the American taxpayer is going to be on the hook if these banks are not able to meet their requirements going forward and need bailouts.

Mr. QUARLES. So we are running stress tests currently, and our stress tests do not assume any stimulus. We are running stress tests currently to determine the resilience of the banking sector. We ran them in the spring. We ran sensitivity analyses in the spring. We are now running additional stress tests, taking into account what happened in the spring and the condition of the banking industry and the economy as a result of that. We will have the results of those stress tests revealed publicly at a bank-by-bank level by the middle of December, and then we will use that information to inform our determination whether we would continue the suspension of the 70 percent of capital distributions that we have already imposed on the banks and the limitation on the dividends that they may pay or adjust that in some way.

Senator WARREN. Let me just stop you there, because we have already had to do this for a long time. Your job is to protect the American people, not the bank investors. And I do not believe you are doing your job. Mitch McConnell has changed his tune. He said he wants to pass a relief bill before the end of the year, and I think that is great. But America needs a real relief bill, not a fig leaf. There are not enough fig leaves on the entire planet to cover up the Republican Party's monumental failure to take this coronavirus seriously.

So Americans are now falling sick at the fastest rate since the pandemic began. It is time for you to stop letting these banks shove money out the door, stop making excuses and do your job.

Thank you, Mr. Chairman.

Chairman CRAPO. Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman.

Vice Chairman Quarles, about a week ago, New York's financial regulator said it would start integrating financial risks into the supervision of New York chartered banks. Among other things, the banks will conduct enterprise-wide risk assessments on how climate change will impact credit risk, market risk, and other core business risks.

Are you following what is going on in New York? And do you agree with the New York regulator that banks should integrate climate financial risks into their risk management frameworks?

Mr. QUARLES. The supervision of the banks is a Board responsibility that is delegated to the reserve banks, so, yes, of course, I am following that, and, of course, I would agree with it. If I did not, it could not happen.

Senator SCHATZ. I want to just follow up on a conversation we had in December on the Fed's joining the Network for Greening the Financial System, which now consists of 75 members and 13 observers. You told me—and this was good. You told me the Fed had been auditing the class before formally registering with the Net-

work for Greening the Financial System. Chair Powell also said last week that the Fed was in the working groups of NGFS.

Where are we on formally joining the Network for Greening the Financial System as a full member or observer?

Mr. QUARLES. So that is really up to the NGFS. We have requested membership. I expect that it will be granted.

Senator SCHATZ. Do you know what the timeframe is?

Mr. QUARLES. I do not. I guess I would say—no, well, they have an annual meeting that is in the spring, which was the last time there was a lot of work around this. But I suspect we could probably join before the spring. That I do not really know, but I can get the answer for you.

Senator SCHATZ. Yes, could you, please? And, also, to the extent that any of this has been reduced to writing in terms of a formal application to become a member or observer, could you provide that to the Committee, please?

Mr. QUARLES. Absolutely, we will get you information on that.

Senator SCHATZ. Thanks very much.

You also said in December that you were closely engaged with the Bank of England on how they are looking at climate change and regulation and supervision. Are you still engaged with the Bank of England? And can you just share with us what you learned or what you are working on?

Mr. QUARLES. Yes, I mean, we just had a tripartite meeting just last week with the Bank of England and the ECB on questions of regulation and supervision. Climate change is obviously something we discussed. We have been particularly monitoring how it is that they are thinking about their inclusion of climate change in their stress-testing process. It is a different process than ours, and they are at a very preliminary level still in the process of thinking about it. But we are definitely involved in the sense that we understand that is involved.

Senator SCHATZ. And just as a point of clarification, because I and others have introduced legislation to this effect, my understanding is that the Fed has the full authority to move forward on this because risk is risk, and it might be helpful to clarify this through a change in statute. But you actually do not need a change in statute to do any of the things that you are doing right now as it relates to climate risk. Is that your assessment?

Mr. QUARLES. That is correct. I do not think that we need a change in statute. It may be—this supervision report that we published last week and that was submitted with my testimony does include a section on climate change and our supervisory activities with respect to climate change. That goes into more detail about how we are thinking about this and incorporating it into our supervisory activities.

Senator SCHATZ. Thank you very much. I really appreciate your work here. And just to point out that we all have different views about climate change and about the solution set that should be undertaken, but risk is risk and the charge for the Fed and other financial regulators is to measure that risk, whether it—whether it has got an ideological argument behind it or not, risk is risk.

I also want to thank the Fed for lowering the minimum loan size threshold from the Main Street Lending Program to encourage

more small businesses to participate, but there appears to be very little uptake. What can we do to push money out to these small businesses who appear to not find this to be a particularly attractive program?

Mr. QUARLES. Well, you know, most of the Fed programs—and the Main Street Program is not different in that respect, the Fed facilities—really operate as backstops. They achieve their function when they restore confidence to the private financing markets, and I think you could say that that has happened with the Main Street Facility as well. So I do not actually view the limited take-up so far of the Main Street Facility as necessarily a sign of its failing. You could view that as a sign of its success if needs are being satisfied by the private sector. That is ultimately what we want as opposed to their being satisfied by the Fed. But I think that it is useful to have it out there as a backstop should the economy develop in a more adverse way and these financing needs not be being met by the private sector.

Senator SCHATZ. Thank you. I appreciate it.

Chairman CRAPO. Thank you, Senator Schatz.

It appears that Senator Van Hollen has had to leave the meeting. Senator Van Hollen, are you with us?

[No response.]

Chairman CRAPO. OK. He may have had to leave the hearing.

Senator Jones?

[No response.]

Chairman CRAPO. That appears to be all of the Senators who are available. Senator Brown, do you want to make a final comment before we conclude the hearing?

Senator BROWN. I do not, Mr. Chairman. Thank you for asking, and thank you to you and the four witnesses.

Chairman CRAPO. All right. Thank you.

Well, then, with that, that will conclude our questions for today's hearing. For Senators who wish to submit questions for the record, those questions are due to the Committee by Tuesday, November 17th.

To each of the witnesses, we ask that you respond to those questions as promptly as you can, and thank you for joining us at the Committee today.

This hearing is adjourned.

[Whereupon, at 4:21 p.m., the hearing was adjourned.]

[Prepared statements, responses to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today we welcome to this virtual hearing the Federal prudential regulators: Federal Reserve Vice Chairman of Supervision, Randy Quarles; Acting Comptroller of the Office of the Comptroller of the Currency, Brian Brooks; Chairman of the Federal Deposit Insurance Corporation, Jelena McWilliams; and Chairman of the National Credit Union Administration, Rodney Hood.

We will receive testimony from each agency on efforts, activities, objectives, and plans since you last testified before the Committee, as well as an update on COVID-19 related actions.

Since the passage of the Coronavirus Aid, Relief and Economic Security Act, or CARES Act, your agencies have taken many meaningful steps to help mitigate the economic impact of the pandemic, and to provide conditions that will lead to a forceful recovery.

On October 30, the Federal Reserve announced changes to its Main Street Lending Facility, including decreasing the minimum loan size for the new loan and priority loan facilities from \$250,000 to \$100,000; and allowing borrowers to deduct any PPP loan less than \$2 million from their outstanding debt for the purposes of the leverage test.

Your agencies should continue to carefully review the regulatory and supervisory frameworks, adjusting where necessary to bolster financial institutions' ability to support economic recovery.

Which, by the way, has shown positive signs of recovery over the last several months.

On October 29, the United States GDP surged a record 33 percent in the third quarter as the economy started to reopen.

The unemployment rate fell to 6.9 percent in October, when just last spring CBO projected that we'd still be at 9.5 percent by the end of 2021.

Since April, around 12 million jobs have been gained, meaning we have recovered more than half of the jobs lost due to shutdowns.

Over the last few months, I have sent several letters to the regulators on a number of important issues.

On July 31, I sent a letter to each of the agencies urging the use of existing discretion to extend relief provided under Title IV of the CARES Act, including: the Community Bank Leverage Ratio to December 31, 2021; Troubled Debt Restructurings (TDRs) to January 1, 2022; and the Current Expected Credit Losses (CECL) methodology to January 1, 2023, while clarifying and minimizing unintended effects of mid-year adoption.

On October 8, I sent the regulatory agencies a letter regarding the increase in regulatory burden for banks and credit unions simply due to their rapid implementation Paycheck Protection Program (PPP).

As a result of their critical role in PPP and the economic recovery, many banks and credit unions inadvertently experienced significant balance sheet growth, which is ultimately expected to decline as borrowers meet the PPP's forgiveness terms.

The FDIC took an important step in issuing an interim final rule to alleviate the increased Part 363 audit and reporting requirements for insured depository institutions (IDIs) that have experienced growth from PPP and participation in the Federal Reserve 13(3) facilities (and other stimulus efforts).

It is important that banks and credit unions are not inadvertently dis-incentivized from continuing to play a key role in the economic recovery or participate in future efforts.

I urge each of you to continue using your discretion to alleviate the regulatory burdens associated with a variety of asset-based regulatory thresholds on those banks and credit unions temporarily experiencing growth from participation in recovery-oriented programs.

Turning to the OCC, on October 19, the Senate rejected a congressional Review Act of the Community Reinvestment Act issued by the OCC.

According to the OCC, the final rule improves Community Reinvestment Act regulations "by clarifying what qualifies for CRA consideration, updating how banks define their assessment areas, evaluating bank CRA performance more objectively, and making the entire process more transparent and timelier. The final rule's framework will increase support to small business, small- and family-owned farms, Indian Country, and distressed areas, and it accommodates banks of all sizes and business models."

The CRA had not been materially modernized since 1995, and I commend the OCC for taking this momentous step.

As we continue to weather this pandemic, I again stress to each of you and your agencies the importance of our financial institutions providing access to credit and financial services to creditworthy individuals and businesses in legal industries.

It is vitally important that our country's financial institutions, especially the largest, not deny credit financing based on political preferences related to firearms, oil and gas, or others.

Lending decisions should be based on creditworthiness, and should not target specific industries, especially as we work to restore our economy to pre-pandemic strength.

This will remain an incredibly important issue for me, and I will continue to fight for access to credit and financial services for all of our legal industries.

I appreciate each one of you joining us today to share your agency's activities and plans, as well as the tireless work of you and your staff in response to COVID-19.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

The American people sent a clear message in this election: they rejected an Administration where Wall Street and corporations run the economy—people want a Government that's on their side.

For the past 4 years, the Trump administration and the Federal financial regulators before us today have put their thumbs on the scale for corporations and their wealthy friends, while leaving everyone else at the mercy of the supposed "free market."

Americans watched a President ignore a pandemic, refuse to even try to put in place any kind of plan to bring the virus under control, and reject all our efforts to support families and get our economy running safely.

And whatever the Majority Leader may say—whatever damage he and some of my colleagues and the outgoing President are doing to our democracy with their lies and their fabricated attacks on our nonpartisan poll workers and local election officials—the facts are clear: a decisive majority of the public—5 million more people voted for Joe Biden than Donald Trump—a decisive majority rejected what they have endured over the last 4 years, and voted for new leadership that will restore faith in our Government.

People are ready to turn the page, they're ready for real leadership that will give them their freedom and their lives back, and they're ready to heal and to rebuild.

The work we do here on the Banking and Housing Committee can be a big part of that, and can make a real, tangible difference in people's lives—if we, Committee Members of both parties, come together and choose to do so.

We have the power on this Committee to tackle the issues that actually matter to people's lives—their paychecks, housing, transportation, and the communities they live in.

We can get small businesses back on their feet. We can lift up the Black and Brown communities that have been hit the hardest by this pandemic. We can keep people in their homes, make those homes more affordable, and bring down people's energy bills. We can lead the world in the fight against climate change and seize every opportunity to create good-paying jobs. We can free people from the stress of debt collectors and the downward spiral of payday lenders.

And we can reorient our economy from wealth to work.

To do all of that, we have to take on Wall Street power.

We know who has been shipping jobs overseas, jacking up drug prices, spending trillions on stock buybacks instead of higher wages, and busting unions: it's not our neighbors who may have a different political sign in their yard or bumper stick on their car—it's the largest corporations, their unaccountable CEOs—Facebook to Wells Fargo—and their allies in Washington.

Wall Street is all too happy to watch phony populists turn us against each other, as long as it means they get to keep exploiting workers and playing by a different set of rules.

For 4 years, we've had a President trying to convince people to blame their fellow Americans who may not look like them or worship like them, instead of blaming a system that rewards executives' stock portfolios when they lay off workers or cut their pay.

Divide to distract—that was the playbook. Divide to distract from all the ways he and his followers in Congress were funneling more wealth to the already-wealthy and more power to the already-powerful.

But it didn't work this time.

Last week, a record nearly 80 million Americans rejected that division that, the largest vote for any Presidential nominee in our country's history. Now, we have to deliver results.

We have to take on Big Oil and other corporate polluters that have spent billions of dollars trying to convince people climate change is an unsolvable problem, instead of a tremendous opportunity.

We have to end the corporate business model that treats workers—especially Black and Brown workers—as expendable, and that perpetuates systemic racism.

We have to break up the biggest banks, and give that power to everyone else who has been denied a voice in our economy.

Our financial system should be a public good. It already is for big banks—we need to make it work for everyone else, and create a better system centered on the Dignity of Work.

When work has dignity, hard work pays off for everyone, no matter who you are, where you live, or what kind of work you do.

When work has dignity, everyone can afford housing and transportation, and they have power over their lives and their own money.

When work has dignity, we have a strong, growing middle class, and everyone—everyone—can reach it.

Making that vision possible is the job of the Banking and Housing Committee.

We know we have great challenges—we're in a public health crisis, an economic crisis, and a climate crisis. And extraordinary times call for us to aim higher and think bigger—to rise to meet this moment, and restore people's faith in their Government.

I look forward to coming together with Senators on both sides of the aisle, and with the new Administration, to get to work.

For release on delivery
2:00 p.m. EST
November 10, 2020

Statement by
Randal K. Quarles
Vice Chair for Supervision
Board of Governors of the Federal Reserve System
before the
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
November 10, 2020

Chairman Crapo, Ranking Member Brown, 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

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

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

<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

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.

For Release Upon Delivery

2:00 p.m.

November 10, 2020

STATEMENT OF

BRIAN P. BROOKS

ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

November 10, 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

Chairman Crapo, Ranking Member Brown, 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 I 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 score⁵ 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

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 2020⁶ 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 presidents of both the NAACP⁸ 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 increased¹⁹ 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.

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. I specifically would like to thank the leadership of Chairman Crapo, Senator Toomey, and Senator Tim Scott for their work supporting the rule.

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

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>).

contract.²⁵

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.

²⁵ "OCC Issues Rule to Clarify Permissible Interest on Transferred Loans." News Release 2020-71. May 29, 2020 (<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>).

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 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

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>).

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 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 framework³¹ is explained in the *Comptroller's Licensing*

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>).

*Manual Supplement: Considering Charter Applications From Financial Technology Companies.*³²

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

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-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->

now firmly entrenched in the financial mainstream. Cryptocurrency has become a popular 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.

bitcoin-buying-binge/#578251402abf

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.

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 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 sessions³⁶ 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 solutions³⁷ 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.

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 or recommendations to guide OCC policy or regulation.

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

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 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

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>).

- 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.

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.

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 be a source of strength, extends opportunities to underserved citizens, and remains committed to the appropriate use of technology.

³⁹ 12 USC 1(a)

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.⁴⁰
- 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.⁴¹
- 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.⁴² 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.⁴³
- On March 17, 2020, federal bank regulators published an [interim final rule](#) to phase in the

⁴⁰ OCC Bulletin 2020-13, "Pandemic Planning: Updated FFIEC Guidance." March 6, 2020 (<https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-13.html>).

⁴¹ 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>).

⁴² 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>).

⁴³ 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.⁴⁴ Clarifying [questions and answers](#) were published on March 19, 2020.⁴⁵

- 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).⁴⁶
- 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.⁴⁷
- 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.⁴⁸
- 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.⁴⁹ 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.

⁴⁴ 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>).

⁴⁵ 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>).

⁴⁶ 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>).

⁴⁷ 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>).

⁴⁸ 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>).

⁴⁹ 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.⁵⁰ 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-19.⁵¹
- On March 25, 2020, the OCC published a [bulletin](#) providing information for essential critical infrastructure workers during the COVID-19 emergency response.⁵²
- 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.⁵³ The OCC issued a [bulletin](#) emphasizing the statement for banks and thrifts.⁵⁴
- On March 26, 2020, the OCC issued a [statement](#) describing the strength and resiliency of the federal banking system in light of COVID-19.⁵⁵
- 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.⁵⁶
- 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.⁵⁷

⁵⁰ 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>).

⁵¹ 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>).

⁵² 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>).

⁵³ 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>).

⁵⁴ 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>).

⁵⁵ 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>).

⁵⁶ 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>).

⁵⁷ 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.⁵⁸
- 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-19.⁵⁹
- 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.⁶⁰
- 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.⁶¹
- 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).⁶²
- 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).⁶³
- 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

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>).

⁵⁸ 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>).

⁵⁹ 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>).

⁶⁰ 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>).

⁶¹ 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>).

⁶² 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>).

⁶³ 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.⁶⁴

- 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.⁶⁵ The agencies also issued a [statement](#) to address challenges relating to appraisals and evaluations for real estate-related financial transactions affected by COVID-19.⁶⁶
- 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.⁶⁷
- 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.⁶⁸
- 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.⁶⁹ 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.⁷⁰

⁶⁴ 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>).

⁶⁵ 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>).

⁶⁶ "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>).

⁶⁷ "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).

⁶⁸ "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>).

⁶⁹ "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>).

⁷⁰ "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.⁷¹ 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-19.⁷² 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-19.⁷³
- 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.⁷⁴
- On June 17, 2020, the OCC issued a [bulletin](#) reminding stakeholders that banks are governed primarily by uniform federal standards.⁷⁵ 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.

⁷¹ "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>).

⁷² "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>).

⁷³ "Supplementary Leverage Ratio: Interim Final Rule." OCC Bulletin 2020-52. May 15, 2020. (<https://occ.gov/news-issuances/bulletins/2020/bulletin-2020-52.html>).

⁷⁴ "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>).

⁷⁵ "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).⁷⁶
- 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.⁷⁷
- 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-19.⁷⁸
- August 7, 2020, the OCC [announced](#) it is reducing assessments in response to the national health emergency related to COVID-19.⁷⁹
- 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.⁸⁰
- 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.⁸¹

⁷⁶ "Assessments: Interim Final Rule." OCC Bulletin 2020-63. June 22, 2020 (<https://www.occ.gov/news-issuances/bulletins/2020/bulletin-2020-63.html>).

⁷⁷ "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>).

⁷⁸ "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>).

⁷⁹ "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>).

⁸⁰ "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>).

⁸¹ "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>).

STATEMENT OF

JELENA MCWILLIAMS
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

OVERSIGHT OF FINANCIAL REGULATORS

before the

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
U.S. SENATE

November 10, 2020

Chairman Crapo, Ranking Member Brown, and members of the Committee, thank you for the opportunity to testify today before the Senate Committee on Banking, Housing, and Urban Affairs.

When I testified 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:

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

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

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/fi20017.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/fi20064.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/fi20036.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/fi20022.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

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 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 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

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 rule²² 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.

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.

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.

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/r3c32620.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.

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.

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 phase 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.

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

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 ANPR⁵⁴ 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.

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 overbreadth 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 –

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
The Honorable Rodney E. Hood
Chairman, National Credit Union Administration
before the
Committee on Banking, Housing, and Urban Affairs
U.S. Senate
November 10, 2020

Chairman Crapo, Ranking Member Brown, and other 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

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 (MDIs). 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.

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.

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.

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>

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 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.

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.

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.

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, 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 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 PhD 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 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.

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

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).

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 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 disruptions, 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

Chairman Crapo, Ranking Member Brown, and other 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

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)

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.

**RESPONSES TO WRITTEN QUESTIONS OF
SENATOR CORTEZ MASTO FROM RANDAL K. QUARLES**

Q.1. Do you pledge to work with President-elect Biden's team to ensure an orderly transition to a new Administration?

Q.2. Have you established office space within your agency for the President-elect's transition team?

Q.3. Have you prepared briefing books for the President-elect's transition team that includes all relevant information they will need to know?

A.1.–A.3. In response to your first three questions, the Federal Reserve is committed to an orderly transition and working with the new Administration. To that end, we facilitated meetings with the transition team as soon as the ascertainment was made by the General Services Administration. The transition team met with many representatives of the Federal Reserve at all levels of the agency. In addition, the transition team met with representatives of some of the Federal Reserve Banks. We provided them with briefings on information they requested.

Q.4. Is troubled debt restructuring merely an accounting issue or are there real concerns about risks to financial institutions?

Q.5. Will your agency update the interagency guidance regarding Troubled Debt Restructuring to allow these COVID–19 loan modifications to extend beyond 6 months? Would loans with terms beyond 6 months still fall within the TDR authority?

A.4.–A.5. In response to questions 4 and 5, 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 (GAAP), which is governed by the Financial Accounting Standards Board. Extending our current guidance beyond 6 months may be contrary to existing U.S. GAAP.

Having said that, TDR relief provided by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) does not have a 6-month time limitation. Modifications longer than 6 months need not be designated as TDRs 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, and 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.

Further, regardless of the TDR designation, the regulatory agencies have released and reiterated guidance that encourages financial institutions to work with their borrowers and highlights that

management will not be criticized for doing so in a prudent manner.

Q.6. Without additional relief from Congress, how bad are defaults, foreclosures, and evictions going to get and what will be the impact on financial institutions?

A.6. As we saw in the financial crisis that attended the 2007–2008 recession, the consequences of widespread mortgage default and foreclosure can be severe. Foreclosures can trigger and exacerbate a housing downturn, which can then spill over to the rest of the economy. A large increase in foreclosures or distressed sales would likely put significant downward pressure on house prices, while a large fall in house prices would damage household balance sheets and would likely reduce residential investment and consumer spending, thereby potentially deepening a recession. In response to falling house prices and rising defaults, mortgage lenders often tighten credit, thus exacerbating price declines and intensifying recessionary dynamics. Moreover, losses on mortgage loans can put substantial strains on the balance sheets of banks and other financial institutions. In addition, households who have undergone eviction or foreclosure face substantial costs, both financial and non-financial. For example, such households typically have persistently lower access to credit and are more likely to experience adverse health outcomes.

A variety of Government policies have attempted to prevent a wave of mortgage defaults, foreclosures, and evictions. The CARES Act gave borrowers with Government-Sponsored Enterprise (GSE) and Government-backed loans access to mortgage forbearance, which helps to prevent default by allowing borrowers to defer mortgage payments for up to 12 months. Although this part of the CARES Act expired at the end of 2020, the GSEs and the Federal Housing Administration have continued their forbearance programs. Private lenders are also offering forbearance, although with terms that are reportedly not as generous as the Government programs. The continuation of forbearance should help to keep people in their homes and support house prices, especially while unemployment remains elevated.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR ROUNDS
FROM BRIAN P. BROOKS**

Q.1. I understand that a company known as Figure Technologies recently applied for a national bank charter but that they wouldn't be taking deposits. This comes about a year after a court decision from the Southern District of New York that argued that the Office of the Comptroller of the Currency doesn't have the legal authority to charter nondepository institutions.

How do you balance the court's decision against the application from companies like Figure Technologies? Is there additional clarity that Congress could provide here to promote innovation while maintaining the safety and soundness of our banking system?

A.1. The New York District Court's holding in *Lacwell v. OCC*, which the OCC has appealed to the United States Court of Appeals for the Second Circuit, addressed an institution that would not be

taking deposits. That holding is not relevant to Figure Technologies' application for a national bank charter because Figure plans to accept deposits and operate as a full-service national bank. Figure will not be FDIC insured, however. Its business plan only entails accepting deposits from institutional clients in amounts over \$250,000, the limit for FDIC insurance. Since all of Figure's deposits will be above the statutory limit for deposit insurance, the OCC will not require the company to seek deposit insurance. However, if its application is approved, Figure will be expected to maintain sufficient capital and liquidity levels, comply with appropriate rules and consumer protections, and will be subject to stringent OCC supervision as required for every national bank. The Figure application is similar to other charter applications from technology companies the OCC has recently approved, such as Varo Bank. Providing a path for these companies to operate within the banking system and to be supervised 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.

Q.2. I appreciate the work that all of you have been doing to help your respective constituents meet the needs of their customers during this difficult time. As I noted in my conversation with Vice Chair Quarles, I have a number of outstanding concerns about some of the unintended consequences that may occur as a result of the unique economic events we're experiencing combined with how consumer activity is changing the balance sheets of banks and credit unions.

Chairman McWilliams said in her written testimony, "The FDIC is also actively considering similar targeted adjustments to further mitigate unintended consequences resulting from pandemic-related Government programs." I know that the Paycheck Protection Program and Economic Impact Payments in particular have resulted in significant cash-flow changes that have made financial institutions look temporarily much larger than normal for the purposes of their capital treatment. Are there other Government programs that have had a similar impact?

A.2. There are currently no Government programs that have had an impact on bank balance sheets on a scale that is similar to the Paycheck Protection Program (PPP) or Economic Injury Disaster Loan (EIDL) program. There are other Government programs that have the potential to increase the size of bank balance sheets; however, their use has been limited compared to the volume of loans provided under the PPP and EIDL. For example, outstanding balances under the Main Street Lending Program, Money Market Mutual Fund Liquidity Facility (MMMFLF), and Paycheck Protection Program Liquidity Facility (PPPLF) were approximately \$69.0 billion in the aggregate as of November 13, 2020. By comparison, PPP-approved dollars totaled approximately \$525.0 billion as of the PPP's program closing on August 8, 2020, and EIDL approved dollars totaled approximately \$194.3 billion as of November 23, 2020.

Q.3. What specific adjustments are you considering as a result of these Government responses?

A.3. The OCC has provided banks with the flexibility to participate in various Government programs and receive capital treatment relief. For example, on November 3, 2020, the OCC published OCC Bulletin 2020-96, “Capital and Liquidity Treatment for Money Market Liquidity Facility and Paycheck Protection Program.” This rule finalized various interim rules and stipulated that a banking organization may continue to exclude assets acquired as part of the MMMFLF and PPP covered loans pledged under the PPPLF from various capital ratio calculations. Further, all PPP loans receive a zero percent risk weighting (the lowest risk weight possible) for capital purposes. In addition, a banking organization subject to the liquidity coverage ratio rule excludes from its total net cash outflow those amounts associated with advances from the MMMFLF and PPPLF and those inflow amounts associated with collateral securing the advances.

Additionally, the OCC, along with the FDIC and Board of Governors of the Federal Reserve System (Board), issued an interim final rule providing relief to community banks that have crossed an asset threshold due to participation in the PPP and other COVID-19 pandemic relief efforts. Community banks with total assets of \$10 billion or less as of 2019, and that have crossed relevant asset thresholds, will have additional time to reduce their asset sizes as the programs unwind or to prepare for new requirements if the banks plan to remain above the asset thresholds in 2022.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT
FROM JELENA McWILLIAMS**

Q.1. The FDIC has long history of working with banks, including mission-driven institutions such as Optus Bank in my home State of South Carolina, to develop policies that support broader access to the financial system.

Can you provide me with an update on the FDIC’s development of guidance to private sector firms that is aimed at facilitating investments in and support of Minority Depository Institutions (MDIs) and Community Development Financial Institution (CDFI) banks?

A.1. One of my priorities as FDIC Chairman has been expanding our engagement and collaboration 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. On October 16, 2020, the FDIC published a resource guide titled “Investing in the Future of Mission-Driven Banks: A Guide to Developing New Partnerships,” which outlines the important role FDIC-insured MDIs and Community Development Financial Institutions (CDFIs) play in the financial system, describes the business needs of these banks, and outlines strategies for private companies and philanthropic organizations to consider in supporting MDIs and CDFIs: equity investments, grants, deposits, creation of an investment fund, technology support, and other partnership opportuni-

ties.¹ These strategies can help MDIs build capacity and scale. We also published an interactive mapping system showing the headquarters and branches of all FDIC-insured MDIs and CDFIs, with links to each bank's website.

In addition, the FDIC is facilitating the creation of a Mission-Driven Bank Fund that will provide opportunities for MDIs to propose investments in equity capital, loan participations, and other mechanisms to help build capacity and scale.² With significant investment commitments by private companies, philanthropic organizations, and other financial institutions, we believe this fund will provide a sizable source of capital and other helpful tools that can help MDIs grow their operations and expand their impact in minority communities.

Q.2. Can you provide an update on the FDIC's work related to the development of a Mission-Driven Bank Fund?

A.2. On November 18, 2020, the FDIC announced a competition to choose one or more experienced financial advisors to support the development of the new Mission-Driven Bank Fund, which will provide a vehicle for private sector and philanthropic investment in FDIC-insured MDIs and CDFIs.³ The selected financial advisor(s) will work with the FDIC to develop the framework, structure, and concept of operations for the Fund. The FDIC received a number of submissions on December 2, and a technical evaluation panel has evaluated the offerors' proposals. The FDIC signed an agreement with a financial advisor on January 11, 2021, and we anticipate the development of the fund structure will take approximately 60 days. Once the Fund is established, an independent investment committee and fund manager will be selected by investors.

**RESPONSE TO WRITTEN QUESTION OF SENATOR TOOMEY
FROM JELENA McWILLIAMS**

Q.1. One way that banks support the mortgage market is through providing warehouse lines of credit to independent mortgage banks. Some argue that capital treatment of warehouse lending is misaligned with the risk of this business. They point out that banks must hold a full 100 percent risk-weighted capital against warehouse lines, even though if banks made the loans themselves, they would have a 50 percent risk weight. Is there merit to lowering the risk weighting to improve mortgage market liquidity and provide a more stable source of support for the mortgage market from banks?

A.1. The bank capital framework is generally implemented on an interagency basis. The FDIC regularly reviews our capital rules, including the risk weights for different assets, both internally and with the other banking agencies. The banking agencies are currently engaged in a rulemaking effort to finalize the outstanding

¹ See FDIC Publishes Resource Guide to Promote Investment Partnerships With FDIC-Insured Minority Banks and Community Development Financial Institutions (Oct. 16, 2020), available at <https://www.fdic.gov/news/pressreleases/2020/pr20111.html>.

² See FDIC, The Mission-Driven Bank Fund, available at <https://www.fdic.gov/regulations/resources/minority/mission-driven/infographic.pdf>.

³ See FDIC Seeks Financial Advisor to Establish New "Mission-Driven Bank Fund" to Support FDIC-Insured Minority Banks and Community Development Financial Institutions (Nov. 18, 2020), available at <https://www.fdic.gov/news/press-releases/2020/pr20125.html>.

components of the Basel III framework, which involves reviewing the risk weights of various asset classes. As part of this process, and as part of our regular review of the impact of capital rules, the FDIC will continue to evaluate whether modifications to the framework are appropriate to support the strong functioning of the U.S. mortgage market.

**RESPONSE TO WRITTEN QUESTION OF SENATOR ROUNDS
FROM JELENA McWILLIAMS**

Q.1. I appreciate the work that all of you have been doing to help your respective constituents meet the needs of their customers during this difficult time. As I noted in my conversation with Vice Chair Quarles, I have a number of outstanding concerns about some of the unintended consequences that may occur as a result of the unique economic events we’re experiencing combined with how consumer activity is changing the balance sheets of banks and credit unions.

Chairman McWilliams said in her written testimony, “The FDIC is also actively considering similar targeted adjustments to further mitigate unintended consequences resulting from pandemic-related Government programs.” I know that the Paycheck Protection Program and Economic Impact Payments in particular have resulted in significant cash-flow changes that have made financial institutions look temporarily much larger than normal for the purposes of their capital treatment. Are there other Government programs that have had a similar impact?

What specific adjustments are you considering as a result of these Government responses?

A.1. 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,¹ which resulted in record deposit inflows at FDIC-insured banks. Banks experienced two consecutive quarters of over \$1 trillion in new deposits, increases 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, 2019.²

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

¹For 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>.

²See 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>.

banks.³ 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.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR KENNEDY
FROM JELENA McWILLIAMS**

Q.1. When the FDIC proposed regulations in 2007 related to industrial loan companies, the agency faced significant pushback from Congress on one issue: applications involving parent companies that engage in commercial activities. Ultimately, the FDIC made the prudent decision to exclude commercial parents in the 2007 proposal.

The world has changed dramatically in the years that have passed. Where commentators were concerned about big physical retailers like Walmart in 2007, now an entirely new generation of internet companies dominate the American economy. Their enormous roles in our lives now raise concerns about the collection and mixing of consumer data in ways we could never have even imagined in 2007. For instance, Apple didn't even launch its first App Store until 2008.

The FDIC's current rule would not exclude applications from commercial parent companies of industrial loan companies. The FDIC's notice of proposed rulemaking lacks any explanation, analysis, or discussion as to why the FDIC changed its 2007 policy on commercial parents.

Can you please explain the FDIC's thinking and, in particular, describe what analyses, studies, or other efforts the FDIC undertook or considered when deciding to change its position from 2007?

A.1. The March 2020 notice of proposed rulemaking (NPR) explained that the FDIC's decision not to go forward with the 2007 proposal was rooted in a number of factors that collectively resulted in reduced organizer interest in establishing new industrial banks. Notably, interest in organizing new institutions of all charter types, including industrial banks, diminished given the deteriorating economic and market conditions (identified as early as mid-2007) resulting in market disruptions, restricted liquidity, reduced availability of capital, and a low interest rate environment. These conditions, in conjunction with the oncoming financial crisis, impacted institutions across the banking industry and resulted in the FDIC not finalizing the 2007 NPR. Instead the FDIC recognized

³See 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>.

the necessity of closely monitoring the performance of industrial banks during that period of severe financial distress.¹

The March 2020 NPR provided a reasoned discussion of the decision to move forward with the proposed rule, and the final rule adopted in December 2020² took into consideration information drawn from the FDIC's supervisory experience in the ensuing years. Industrial banks today are owned by financial and non-financial commercial firms. Overall, the performance and condition of industrial banks during the most recent banking crisis was consistent with other FDIC-insured institutions based on assigned supervisory ratings, which consider each institution's unique business model, complexity, and risk profile. As discussed in the final rule, from the beginning of 2009 through 2011, on average, industrial banks were assigned composite and component ratings similar to other charter types with regard to safety and soundness, consumer protection, and the CRA. Further, the portfolio of industrial banks reflected similar proportions of institutions that were composite rated 3, 4, or 5³ during the crisis, as well as a similar rate of failure as compared to the portfolio of traditional insured institutions.

While some industrial banks have pursued nontraditional business models, industrial banks as a whole have experienced financial performance and condition results comparable to nonindustrial bank-insured institutions. Industrial banks tend to maintain higher levels of capital and generate higher earnings than their commercial bank peers. At year-ends 2009 through 2011, industrial banks maintained a median tier 1 leverage capital ratio between 13.1 percent and 15.4 percent, whereas other insured institutions maintained a median tier 1 leverage capital ratio between 9.3 percent and 9.7 percent. As of June 30, 2020, the median tier 1 leverage capital ratio for industrial banks was 14.6 percent, compared to 10.3 percent for other insured institutions.⁴

Similarly, industrial banks reported a median return on average assets (ROAA) ratio of between 0.6 percent and 2.5 percent at year-ends 2009 through 2011, versus a median ROAA ratio of between 0.4 percent and 0.7 percent for other insured institutions. The median ROAA ratio for industrial banks and other insured institutions as of June 30, 2020, were 1.1 percent and 0.9 percent, respectively.⁵

Further, during the same time period, industrial banks have been assigned UFIRS examination ratings for the capital and earnings components that, on average, were very similar to those of other insured institutions. This generally indicates that industrial banks have implemented and maintained appropriate risk management practices that, given financial condition and performance,

¹After 2013, the moratorium imposed by Congress in the Dodd-Frank Act expired by its terms and was not renewed.

²See 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>.

³Each financial institution is assigned composite and component ratings for safety and soundness under the Uniform Financial Institutions Rating System (UFIRS). Under the UFIRS, composite ratings are based on an evaluation and rating of six essential components of an institution's financial condition and operations: adequacy of capital, the quality of assets, the capability of management, the quality and level of earnings, the adequacy of liquidity, and the sensitivity to market risk. Evaluations of the components take into consideration the institution's size and sophistication, the nature and complexity of its activities, and its risk profile.

⁴FDIC Call Report Data, June 30, 2020.

⁵Id.

have adequately compensated for the risks inherent in the business models.

Finally, industrial banks experienced failures during the crisis at about the same rate as other types of institutions, and there have not been any industrial bank failures since 2010.⁶

The final rule includes a number of regulatory requirements, including heightened source of strength requirements, to address potential risks. Both the NPR and Supplementary Information portion of the final rule provide additional details on the justification and factual underpinnings of the rule.⁷

Q.2. Given the limited discussion in the Federal Register on this dramatic change in the FDIC's position on this issue, how can you expect the public to meaningfully provide comments on the potential impact of opening your proposal to commercial parent companies?

A.2. The FDIC has an obligation to effectively and transparently execute the law authorizing the establishment of industrial banks. The final rule, which is consistent with the FDIC's historical practice regarding the establishment and supervision of industrial banks, provides transparency on this process while incorporating 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.

The NPR discussed the history of industrial banks in the United States, both generally and in the context of controversies over the past two decades. The NPR reviewed potential risks inherent in approving and supervising industrial banks. These include concerns over the mixing of banking and commerce, as well as the potential risk to the Deposit Insurance Fund posed by the lack of Federal consolidated supervision of parent companies. The NPR also set out the justification for the proposed rule, including the need to codify and clarify supervisory expectations for industrial banks and the importance of imposing commitments on parent companies to ensure the parent company can serve as a source of strength for its subsidiary industrial bank.

The NPR specifically discussed that commenters on the 2007 rulemaking observed that the FDIC lacked authority to draw a distinction between financial and nonfinancial industrial bank owners absent a change in law.

The NPR provided discussion of the factual, legal, and policy considerations for the proposed rule, such that interested parties were able to—and did—submit a variety of comments on a number of issues raised in and by the proposed rule.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER
FROM JELENA McWILLIAMS**

Q.1. *Impact of Pandemic on Regulatory Asset Thresholds:* During the pandemic, because of participation in the Paycheck Protection

⁶Security Savings Bank, Henderson, Nevada, failed in February 2009, and Advanta Bank Corporation, Draper, Utah, failed in March 2010.

⁷See supra note 11.

Program, EIDL, EIP, USDA emergency programs, and others—as Chairman Crapo and Senator Toomey highlighted during the hearing—a number of financial institutions have grown to new regulatory thresholds, and for many this will be temporary.

I'm very proud of the work that community banks and credit unions in Montana have done to help their communities during this health and economic crisis, particularly the effort it has taken to make the Paycheck Protection Program work despite many challenges. I am concerned though that these community financial institutions will face unnecessary consequences from these important programs and may be unable to participate in future rounds of these stimulus programs.

Thank you to you all for your focus on the disproportionate impact that these increased assets have on smaller institutions. This is a problem I'm hearing about directly from Montanans, and like you we've seen that these pandemic-related assets have a more significant impact the smaller a bank is. Especially for these smaller banks, the problems with increased pandemic-related assets are not limited to PPP.

I know that this is something all of your agencies are looking into and some have taken action on. I appreciated hearing your answers to the Chairman's question, and I look forward to continuing to work with you all on this issue.

What can your agencies do to ensure financial institutions are not punished for participating in these programs while also maintaining the safety and soundness of the system?

Can you do this all on your own or are there areas that require action from Congress?

A.1. 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,¹ which resulted in record deposit inflows at FDIC-insured banks. Banks experienced two consecutive quarters of over \$1 trillion in new deposits, increases 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, 2019.²

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

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²See *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>.

banks.³ 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.

Q.2. *Impact of Pandemic on Safety and Soundness:* This pandemic has had significant impacts on our economy and communities throughout the country.

As you continue examinations, what impact are you seeing these factors have on the banks and credit unions you regulate? Is this impact different on smaller, community institutions?

A.2. 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.⁴ 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.

Community banks continued to outperform the industry overall with stronger improvements in annual net income and loan growth. Specifically, the 4,590 FDIC-insured community banks reported quarterly net income of \$7.3 billion, a 10 percent increase year-over-year. However, community banks continued to report an annual increase in provisions, further net interest margin compression, and a modest increase in nonperforming loans.

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

³See 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>.

⁴See 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>.

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.

Q.3. *Risks in Financial System:* For the past 8 months much of everyone's focus has been on the health and economic crisis. But everything else hasn't stopped because of the coronavirus, even if at times it feels that way.

Are there trends that you are seeing or problems you are concerned about that we aren't focused enough on during the pandemic?

A.3. While responding to the economic risks related to COVID-19 has been a top priority for the FDIC since the beginning of the pandemic, our key supervisory and other essential functions have remained operational. Using technology, we have maintained our supervisory activities during the pandemic, working offsite to protect our examiners and bank employees. When necessary, we have provided institutions flexibility regarding the initiation of an examination; however, such extensions have generally been for only brief periods of time.

We continue to actively monitor the financial system, including potential risks that preceded the pandemic. Among other things, we continue to actively monitor cybersecurity risks in the banking industry, and our examinations seek to ensure that financial institutions are appropriately managing their exposure to such risks. In addition, we recognize that the role of banks within the financial system continues to evolve. For example, a substantial portion of mortgage servicing and origination has migrated outside the banking system, and policymakers must consider the risks and benefits of this migration with respect to both financial stability and credit availability.

Q.4. *Post-Pandemic Economy:* As the pandemic continues our economy continues to suffer, and I am concerned that we will have another slow, uneven recovery like we saw after the most recent economic crisis. A concern I know many here share.

What are your top priorities to make sure that that doesn't happen? What more should Congress be doing to address the long-term implications of this crisis?

A.4. Although the future path of the economy remains somewhat uncertain, we have seen the economy begin to recover from the first two quarters of 2020, and we remain optimistic that as the vaccine distribution process will promote continued economic growth. Nonetheless, the FDIC remains focused on the resiliency of the banking sector and ensuring we are prepared for any possible outcomes. As we did in 2020, we will continue to provide needed flexibility for banks to work with their borrowers and modify loans when appropriate.⁵ In 2020, we confirmed with the staff of the

⁵ 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

Financial Accounting Standards Board (FASB) that short-term modifications (e.g., 6 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. 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. These actions have supported the ability of banks to work with their borrowers, and we will continue to take additional actions as appropriate.

Q.5. Rural Branches: I have been long concerned about consolidation among financial institutions. It's hard for small communities to survive without a post office and a bank or credit union branch.

Has the coronavirus pandemic changed trends you have been seeing in recent years around the closure of branches? Or mergers and acquisitions?

Is there more that should be done legislatively or through regulation to address branch closures?

A.5. I deeply appreciate the challenge for rural communities posed by branch closures. The FDIC is the primary Federal regulator for most agricultural banks and thus understands these challenges firsthand. For example, between 1980 and 2010, more than half of all rural counties across the United States lost population, and the rural counties that experienced outflows lost 14.8 percent of their population on average.⁶ Although community banks in depopulating areas have been resilient in meeting the challenges posed by these demographic trends, the eroding size of the local customer base makes it harder to raise deposits and attract loan customers.

The need for a strong community banking sector in rural areas is underscored by the uneven distribution of banking offices across the country. As of June 30, 2019, 620 counties—or 20 percent of the counties across the Nation—were served only by community banking offices, 127 counties had only one banking office, and 33 counties had no banking offices at all.⁷ We have taken a number of steps to increase the competitiveness of community banks, including by working to remove unnecessary barriers for institutions seeking to innovate. In addition, we continue to focus on agricultural lending and the ability for farm banks, which represent nearly one-quarter of all FDIC-insured institutions, to manage amid changing industry conditions.⁸ With respect to branch closures, insured depository institutions (IDIs) must provide notice of proposed

with Customers Affected by the Coronavirus (Mar. 22, 2020), available at <https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html>.

⁶See FDIC, Long-Term Trends in Rural Depopulation and Their Implications for Community Banks, available at <https://www.fdic.gov/bank/analytical/quarterly/2014-vol8-2/article2.pdf>.

⁷See FDIC Summary of Deposits, available at <https://www7.fdic.gov/SOD>.

⁸See FDIC 2019 Risk Review, available at <https://www.fdic.gov/bank/analytical/risk-review/full.pdf>.

closures to customers and the appropriate Federal banking agency, but such closures are not subject to application requirements or regulatory approval. Section 42 of the FDI Act requires IDIs to give written notice to customers and the appropriate Federal banking agency no later than 90 days prior to the date of the proposed branch closure.⁹

Section 42 imposes additional notice requirements on interstate banks that propose to close any branch in a low- or moderate-income area, and, under certain circumstances, authorizes the appropriate Federal banking agency to take action to convene a meeting of stakeholders in the affected area.¹⁰ However, section 42 clarifies that such action may not affect the authority of the bank to close the branch so long as the notice requirements of section 42 are satisfied.¹¹ The FDIC is the primary Federal supervisor for more than 3,000 community banks and, as such, will ensure through our examination and supervisory processes that these institutions satisfy the notice requirements of section 42, consistent with the Inter-agency Policy Statement Concerning Branch Closing Notices and Policies (Policy Statement).¹²

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN
FROM JELENA McWILLIAMS**

Q.1. Last month, the FDIC released the 2019 Survey of Household Use of Banking and Financial Services, which found that 5.4 percent of U.S. households were unbanked. Describe how the FDIC plans to utilize these findings to address and bring greater attention to some of the most common reasons why individuals do not have accounts at insured depository institutions, including:

- Not having enough money to meet minimum balance requirements
- Lack of trust in the banking system
- High and unpredictable account fees
- Inconvenient hours or locations

A.1. Building on the FDIC's longstanding goal of bringing more Americans into the banking system, we have made significant progress to support communities in need, especially low- and moderate-income communities. As we consider additional ways to create a more inclusive banking system, we 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.

One example is the use of alternative data in credit underwriting. 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.

⁹ 12 U.S.C. § 1831r-1(a)-(b). IDIs must also post a notice on the premises of a branch proposed to be closed for a period of at least 30 days prior to the proposed closing. 12 U.S.C. § 1831r-1(b)(2)(A).

¹⁰ 12 U.S.C. § 1831r-1(d).

¹¹ 12 U.S.C. § 1831r-1(d)(3).

¹² See Branch Closings, 64 Fed. Reg. 34845 (June 29, 1999), available at <https://www.govinfo.gov/content/pkg/FR-1999-06-29/pdf/99-16471.pdf>.

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. Last year, the FDIC, jointly with the other Federal regulators, issued a statement encouraging the responsible use of alternative data in credit underwriting to facilitate greater access to credit.¹ We continue to engage with our fellow regulators to consider other potential steps that would further encourage and facilitate the use of alternative data.

Similarly, we issued principles encouraging financial institutions to offer responsible small-dollar loans to customers for both consumer and small business purposes.² We recognize 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 low- and moderate-income 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.

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.³ 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.⁴

Risk management is an important component of third-party partnerships with banks. But the onboarding 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 paper-

¹See 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>.

²See 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>.

³See FDIC, Conducting Business with Banks: A Guide For Fintechs And Third Parties (February 2020), available at <https://www.fdic.gov/fditech/guide.pdf>.

⁴See 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>.

work and review requirements for vendors are multiplied at each new institution.

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 onboard 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 antidiscrimination.

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.

Q.2. The FDIC supervises a large number of community banks. Please describe the impact of the following on the health of these institutions.

- The short-term impacts of COVID-19 and delayed fiscal support.
- The long-term implications of depressed net interest margins due to prolonged low interest rates for the foreseeable future.

A.2. 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.⁵ 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.

Community banks continued to outperform the industry overall with stronger improvements in annual net income and loan growth. Specifically, the 4,590 FDIC-insured community banks reported

⁵ 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>.

quarterly net income of \$7.3 billion, a 10 percent increase year-over-year. However, community banks continued to report an annual increase in provisions, further net interest margin compression, and a modest increase in nonperforming loans.

Q.3. In its COVID sensitivity analyses, the Federal Reserve noted that “Supervisors remain focused on certain firms that are particularly sensitive to the current economic outlook, whose outlooks are more optimistic than appropriate given current conditions, whose credit cost forecasts have not considered a range of possible outcomes, or whose planning has not been thoughtful.” Have FDIC supervisors made any similar observations, either at the bank-level of the entities subject to the Fed’s stress testing framework or for any of the banks under FDIC supervision? If so, what actions has the FDIC taken in response?

A.3. 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.

Q.4. Last month, the agencies issued a final rule for the Net Stable Funding Ratio, one of the key pillars of the post-crisis liquidity framework established by the Basel Committee. The final rule was substantially weaker than the proposal released in 2016 as a result of eliminating U.S. Treasuries and reverse repos from the Required Stable Funding (RSF). The cost-benefit analysis of that rule evaluated the costs of greater risk weights for these assets against the benefits of “mitigating the risk of sharp price declines of level 1 liquid asset securities,” and the fact that “a small RSF requirement on level 1 liquid assets would ensure that covered companies fund a small portion of these securities from stable sources, which could ease the liquidity pressure caused by price declines and thus potentially reduce the need for liquidity support in times of stress.”

- How did the agencies consider the actions of the Federal Reserve to stabilize these markets earlier this year when conducting this analysis, given that no RSF requirement was in place?
- Did your agency conduct any independent analysis of the impact of a small RSF requirement on the disincentivizing covered companies from acting as intermediaries of U.S. Treasury and repo markets during times of stress? If so, please provide that analysis.
- Does the analysis assume that the Federal Reserve will always be able to provide support to these markets in the event of a crisis?

- How did the agencies quantify the cost of Federal Reserve intervention?

A.4. 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 banks⁶ 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.⁷ The LCR requires the largest banks to maintain sufficient high-quality liquid assets (HQLA) to meet their total net cash outflows over a 30-day period.

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.

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.⁸ The NSFR will require covered banks to maintain stable funding to support their assets, commitments, and derivatives exposures over a 1-year time horizon. In recognition of the low risk to a bank's funding profile posed by HQLA, the rule will not require stable funding to be held against unencumbered level 1 liquid assets and short-term secured lending transactions backed by level 1 liquid assets (e.g., U.S. Treasury securities). These assets serve as reliable sources of liquidity based on their high credit quality, and they serve a critically important role in supporting the smooth functioning of funding markets.

**RESPONSES TO WRITTEN QUESTIONS OF
SENATOR CORTEZ MASTO FROM JELENA McWILLIAMS**

Q.1. Do you pledge to work with President-elect Biden's team to ensure an orderly transition to a new Administration?

A.1. Yes. The FDIC has met all requirements of Government agencies under the Presidential Transition Act of 1963. I have met virtually with President-elect Biden's agency review team. Our senior career official responsible for transition planning has engaged with the agency review team shortly after the election. FDIC staff has provided timely responses to all requests from the agency review team, including all interviews and other questions.

Q.2. Have you established office space within your agency for the President-elect's transition team?

⁶These 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.

⁷See 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>.

⁸See 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>.

A.2. The FDIC offered the agency review team physical space at our offices, which they did not opt to use. Consistent with their requests, all meetings have been conducted virtually due to the COVID-19 pandemic.

Q.3. Have you prepared briefing books for the President-elect's transition team that includes all relevant information they will need to know?

A.3. Yes, we prepared and delivered an extensive briefing book for the agency review team covering all aspects of the FDIC's operations and activities. In addition, we have conducted 16 separate meetings between the agency review team and FDIC senior officials, and we have provided timely responses to all other information requests.

Q.4. Are community banks at risk of failure due to the inability of some of their commercial real estate or mortgage borrowers to pay their loan on time and in full?

A.4. 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.

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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 aggre-

¹See 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>.

gate 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.

Q.5. Previously, you had stated that modifications were not considered TDRs. Is that still the case?

A.5. Beginning in March 2020, the FDIC, jointly with the other Federal regulators, provided needed flexibility for banks to work with their borrowers and modify loans when appropriate.² We confirmed with the staff of the Financial Accounting Standards Board (FASB) that short-term modifications (e.g., 6 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. 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.

Q.6. Has the FDIC issued guidance to ensure that banks are working with their borrowers to defer payments? Specifically, how are lenders working with property owners and landlords to pay their bills even when tenants are unable to pay the rent?

A.6. On March 13, 2020, the FDIC issued a statement encouraging institutions to assist consumers and communities affected by COVID-19.³ 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, jointly with the other Federal regulators, provided needed flexibility for banks to work with their borrowers and modify loans when appropriate. 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

²See 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>.

³See 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>.

payment due date.⁴ 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.

Q.7. Will your agency update the interagency guidance regarding Troubled Debt Restructuring to allow these COVID–19 loan modifications to extend beyond 6 months? Would loans with terms beyond 6 months still fall within the TDR authority?

A.7. According to U.S. generally accepted accounting principles, a restructuring of a debt constitutes a TDR if the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. The TDR designation is an accounting categorization, as promulgated by FASB and codified in ASC Subtopic 310–40.

As noted above, in March 2020, the FDIC and our fellow regulators confirmed with the staff of the FASB that short-term modifications (e.g., 6 months) made on a good faith basis in response to COVID–19 to borrowers who were current prior to any relief are not TDRs under ASC Subtopic 310–40. Additionally, under Section 4013 of the CARES Act, eligible loan modifications 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.

Q.8. The FDIC report on unbanked and underbanked excluded the underbanked data. Why did this biannual study decide not to include underbanked individuals?

A.8. In October 2020, the FDIC released our latest biennial survey on household use of banking and financial services.⁵ The survey was conducted in June 2019, collecting responses from almost 33,000 households on bank account ownership, the primary methods banked households use to access their bank accounts, bank branch visits, use of prepaid cards and nonbank financial transaction services, and use of bank and nonbank credit.

The FDIC did not exclude underbanked households from the survey. In fact, the survey continues to collect detailed statistics on the use of nonbank financial services by American households. While we have eliminated the term “underbanked” from the report due to the intrinsic subjectivity of the definition and the evolution of the financial services system, the report presents extensive and detailed information about households that use nonbank financial products and services, as in prior reports.

The FDIC’s past six reports utilized five different definitions of “underbanked,” which has made it impossible to compare results from one survey to another. The changing definitions of “underbanked” reflect the increasing difficulty of capturing this term and measuring its prevalence. Consumers often make choices not based

⁴See 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>.

⁵See How America Banks: Household Use of Banking and Financial Services, 2019 FDIC Survey, available at <https://www.fdic.gov/analysis/household-survey/2019report.pdf>.

on whether a service is offered by a bank or nonbank financial institution, but based on factors such as price or convenience.

Since the survey was first published more than a decade ago, new financial products have proliferated, and it has become increasingly problematic to characterize individuals who have bank accounts as “underbanked” based solely on their use of financial products and services offered by nonbanks. Further, both banks and nonbanks may offer many of the same products and services. For example, the 2019 survey found that over 32 percent of banked households used nonbank peer-to-peer or person-to-person (“P2P”) services. Moreover, the majority of those banked households fell into the highest income and highest education levels surveyed. Characterizing such well-educated, higher-income households as “underbanked” solely because they used a P2P service offered by a nonbank seems not only inaccurate, but also inapposite to the underlying statutory purpose of the survey: gaining a better understanding of the efforts by banks to bring the unbanked into the conventional banking system.

Q.9. Without additional relief from Congress, how bad are defaults, foreclosures, and evictions going to get and what will be the impact on financial institutions?

A.9. Notwithstanding continued economic uncertainty related to the trajectory of COVID-19, the banking industry remains well capitalized with ample liquidity and has, to date, weathered the economic effects of the pandemic. The FDIC continues to monitor and report on conditions and take actions to support the ability of banks to work constructively with their customers.

Q.10. The recent expose of Suspicious Activity Reports (SARs) filings sent shockwaves through the financial industry.

The article reported multiple examples of major financial institutions failing to take proactive action regarding customers on whom they have filed SARs and/or against whom they have suspicions of illegal activity, how big of a concern is this for your agency?

A.10. The purpose of a Suspicious Activity Report (SAR) filing is for financial institutions to describe and report to the Financial Crimes Enforcement Network (FinCEN) any suspected or potential illegal activity they observe. However, the filing of a SAR is not itself evidence of wrongdoing. Each insured financial institution⁶ is required to file SARs based on the relatively low-level evidentiary threshold of “suspicion.” As such, there are no Bank Secrecy Act (BSA) requirements for financial institutions to terminate a customer relationship after identifying potentially suspicious activities.

After the filing of an initial SAR, financial institutions are requested pursuant to FinCEN’s guidance to file additional SARs (commonly referred to as “continuing activity SARs”) with FinCEN every 90 days if a customer’s unusual or suspicious transactions continue. Ultimately, the decision to establish, maintain, or close an account is made by a financial institution in accordance with its own policies, procedures, and processes. Those decisions are made

⁶The term “financial institution” in this response is a substitute for the term “bank” and “State bank” as defined in Section 3 of the Federal Deposit Insurance Act.

based on the information available to the financial institution, the institution's customer risk profile, and the institution's assessment of ongoing risks associated with its customer.

The BSA provides financial institutions with flexibility in how they develop risk-based procedures and monitoring processes for the purpose of updating customer due diligence information and determining when to close accounts. As part of their BSA/AML compliance program requirement, FDIC-supervised financial institutions are required to have written policies, procedures, and processes that, among other things, address the identification and reporting of suspicious activity and the escalation process for decisions to maintain or terminate customer relationships based on relevant factors, including SAR filings. If the financial institution chooses to maintain an account, it is required to comply with all applicable BSA requirements, including requirements to conduct ongoing monitoring on the basis of risk, and, as appropriate, file SARs, including, as applicable, continuing activity SARs.

An important consideration when evaluating financial institutions' actions regarding customers on whom they have filed SARs is that law enforcement may send "keep open" letters to financial institutions requesting, but not requiring, they keep accounts open, so as not to impair ongoing investigations. Although there is no requirement that a financial institution keep accounts open, FinCEN has encouraged financial institutions to be mindful that complying with a "keep open" request may further law enforcement efforts to combat money laundering, terrorist financing, and other crimes. In the event a financial institution keeps the account open, the financial institution still must comply with its requirement to file SARs when appropriate.

Under Section 8(s) of the Federal Deposit Insurance Act (FDIA), FDIC's examination of an institution is required to include a review of the institution's BSA/AML compliance program, and FDIC reports of examination are required to describe any problems with the compliance program. Furthermore, section 8(s)(3) of the FDIA requires the FDIC to issue a cease and desist order against an institution if it has defects in its BSA/AML compliance program in one or more program components that indicate that either the written BSA/AML compliance program or its implementation is not effective. Examples include, but are not limited to, deficiencies that are coupled with other aggravating factors, such as (i) highly suspicious activity creating a potential for significant money laundering, terrorist financing, or other illicit financial transactions, (ii) patterns of structuring to evade reporting requirements, and (iii) systemic failures to file SARs, or other required BSA reports.

Historically, during any given time period, the overwhelming majority of FDIC-supervised financial institutions subject to examinations have BSA/AML compliance programs, including SAR monitoring and reporting processes that are considered acceptable by FDIC examiners.

Q.11. One of the allegations in the investigation was that financial institutions did not list the relationship manager within their own institution. Is your agency aware of whether this problem is prevalent?

A.11. The financial institution’s relationship manager is not a required SAR data input field. On June 19, 2000, the Federal financial institutions supervisory agencies, together with FinCEN, issued a revised SAR form effective December 31, 2000.⁷ As part of the modifications to the SAR form, two sections requiring “witness” and “preparer information” were replaced with Part IV, “Contact for Assistance.” Subsequent revisions to the SAR form associated with FinCEN’s July 1, 2012,⁸ implementation of a new BSA E-Filing system, replaced the “Contact for Assistance” field with “Filing Institution Contact Office” and “Filing Institution Contact Phone Number.” These revisions further anonymized the specific financial institution personnel involved in the SAR filing for the safety of such individuals in case a SAR was made public.

Current SARs cannot be submitted by financial institutions to FinCEN without the required financial institution “Contact Office” and “Phone Number” fields. Since every SAR has a financial institution contact office for law enforcement and regulatory personnel to contact in order to obtain additional information about the SAR filing, the FDIC does not believe failure to list a relationship manager is a prevalent problem.

Q.12. It is important that SARs remain confidential. Are you working with FinCEN to ensure future leaks will not occur?

A.12. The FDIC recognizes the importance of SAR confidentiality. The unauthorized disclosure of SARs is a crime that can impact the national security of the United States, compromise law enforcement investigations, and threaten the safety and security of the institutions and individuals who file such reports. It is critical that the existence of a SAR be kept confidential, as well as the information contained in the SAR. It is essential to the partnership between the financial industry and Government that sensitive and confidential financial and personal information reported to FinCEN be protected.

Given the confidential nature of this information, we continually stress the importance of SAR confidentiality and security with the intuitions we supervise, with our staff, and with the other regulators, including FinCEN, to ensure protection of data.

The FDIC is aware that FinCEN has referred this particular SAR disclosure matter to the U.S. Department of Justice and the U.S. Department of the Treasury’s Office of Inspector General. The FDIC is not privy to the source or circumstances surrounding the leak. Once such information is available to the FDIC, we will be in a better position to work with FinCEN to implement any necessary additional, proactive measures to ensure SAR data confidentiality and security.

⁷See Revised Suspicious Activity Report Form (SAR) (June 19, 2020), available at <https://www.fincen.gov/news/news-releases/reviced-suspicious-activity-report-form-sar>.

⁸See Filing FinCEN’s new Currency Transaction Report and Suspicious Activity Report (Mar. 29, 2012), available at <https://www.fincen.gov/resources/statutes-regulations/guidance/filing-fincens-new-currency-transaction-report-and>.

**RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA
FROM JELENA McWILLIAMS**

Q.1. As you know, the commercial real estate (CRE) market is under extreme pressure due to this pandemic. Collapse of this market would be disastrous to Arizona communities. In April, the regulators released the “Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus.” This guidance allowed financial institutions to modify existing CRE loans impacted by the coronavirus. While this guidance was helpful and much-needed, it now requires updating. Are there plans to update this guidance to allow these COVID loan modifications to extend beyond 6 months?

A.1. Beginning in March 2020, the FDIC and our fellow regulators provided needed flexibility for banks to work with their borrowers and modify loans when appropriate.¹ We confirmed with the staff of the Financial Accounting Standards Board (FASB) that short-term modifications (e.g., 6 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. 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.

**RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY
FROM RODNEY E. HOOD**

Q.1. What is the likelihood of NCUA charging a Share Insurance Fund premium either this year or next year?

A.1. As required by the Federal Credit Union Act, the NCUA must maintain an equity ratio between 1.2 and 1.5 percent in the National Credit Union Share Insurance Fund (NCUSIF). There are several scenarios under which the NCUA would be required to assess an insurance premium based on the equity ratio. For example:

- If the equity ratio falls below 1.3 percent, the NCUA may assess an insurance premium to insured credit unions to restore the equity ratio up to, but not above, 1.3 percent.
- If it is projected that the equity ratio will fall below 1.2 percent within 6 months of determination, or if the equity ratio has actually fallen below 1.2 percent, the NCUA must establish and implement a fund restoration plan within 90 days to restore and maintain the equity ratio at 1.2 percent.

¹ 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>.

- In the event that the equity ratio falls below 1 percent, the NCUA would require insured credit unions to recapitalize the NCUSIF in addition to the insurance premiums assessed by the NCUA.

The NCUA calculates the equity ratio bi-annually as of June 30 and December 31 each year. The NCUSIF equity ratio is calculated as the sum of NCUSIF contributed capital and results of operations, less any unrealized gains, divided by the total insured shares. The equity ratio can decline either through a decrease in the retained earnings from the NCUSIF operating results or an increase in the total insured shares.

As of the June 30, 2020, calculation, the NCUSIF equity ratio declined by 13 basis points in a 6-month period to 1.22 percent. The decline in the equity ratio during this period was the result of unprecedented growth in insured shares during the first 6 months of 2020. Insured shares grew at a nonannualized rate of 12.95 percent. Historically, the average insured share growth rate has been 4.58 percent. The sum of contributed capital and retained earnings, less contingent liabilities, also increased during the 6 months, but at a much lower rate than the insured shares. Based on forecasted share insurance growth and fund equity values, the NCUA projected the December 31, 2020, NCUSIF equity ratio at 1.32 percent.

At this time, the NCUA does not project that the NCUSIF equity ratio will fall below 1.2 percent in the next 6 months. As always, economic uncertainties could impact the accuracy of this projection, including the length of time necessary for a full economic recovery and the impacts on the financial services industry. Likewise, continued strong growth in insured shares and low interest rate returns on the NCUSIF portfolio are also factors that depress the equity ratio. While economic stress related to COVID-19 has lowered net interest margins impacting earnings, asset quality and capital adequacy remain strong. The NCUA continues to evaluate how a variety of stress scenarios could impact the NCUSIF's performance in the event a fund restoration plan becomes necessary.

Q.2. What is the status of NCUA's efforts to improve examinations, including by making them less burdensome, streamlining virtual examinations, and improving the agency's use of technology?

A.2. In 2017, the NCUA Board approved the virtual examination project and associated resources to research methods to conduct off-site as many aspects of the examination and supervision processes as possible. Currently, the program is in the research and discovery phase. During this phase, the NCUA researching ways it can harness new and emerging data, assess advancements in analytical techniques, and utilize innovative technologies. Additionally, the NCUA is identifying ways to improve its supervisory approach and to move to a more virtual-based examination model in the next 5 to 10 years. By identifying and adopting alternative methods to remotely analyze much of the financial and operational condition of a credit union, with equivalent or improved effectiveness relative to current examinations, it may be possible to significantly reduce the frequency and scope of onsite examinations. However, this examination model will encompass more than just the element of

working offsite. The NCUA seeks to modernize and reengineer the way the agency:

- Collects data from credit unions;
- Performs analytics and evaluate risk through advanced analytics tools; and
- Conducts the examination by incorporating alternative examination techniques, tools, and automation.

The virtual examination model should lead to greater use of standardized interaction protocols, advanced analytical capabilities, and subject matter experts, resulting in more consistent and accurate supervisory determinations, providing greater clarity and consistency with respect to how the agency conducts supervisory oversight, and reducing coordination challenges between agency and institution staff. Through this modernization effort, the NCUA intends to reduce the burden on credit unions, improve offsite supervision capabilities, provide more consistency and standardization for the examination and supervision process, and explore and evaluate technology utilization and the industry's interest in adopting the technology.

The first step in this modernization initiative is the NCUA's Enterprise Solution Modernization program. This is a long-term effort to introduce emerging and secure technology in support of the agency's examination, data collection, and reporting efforts. The modernization's objectives include streamlining and aligning examination and data processes, technology, and infrastructure across business functions, as well as gaining process efficiencies with integrated, scalable platforms, and robust tools. The first project of this initiative, a new examination tool, was introduced to pilot participants in September 2019; due to the COVID-19 pandemic, however, the broader rollout was delayed until 2021.

The new examination tool will make examinations less burdensome by providing the ability to securely request and submit documents and information for the examination in an organized manner that is easily accessible to members of an exam team. It also reduces burden by giving credit unions the opportunity to manage examination findings and view completed examination reports securely from one application. Integrated robust financial analytics, including loan and share analytics helps provides support for virtual examinations. This new examination tool leverages technology with a scalable infrastructure to facilitate and streamline a virtual examination program.

**RESPONSE TO WRITTEN QUESTION OF SENATOR ROUNDS
FROM RODNEY E. HOOD**

Q.1. I appreciate the work that all of you have been doing to help your respective constituents meet the needs of their customers during this difficult time. As I noted in my conversation with Vice Chair Quarles, I have a number of outstanding concerns about some of the unintended consequences that may occur as a result of the unique economic events we're experiencing combined with how consumer activity is changing the balance sheets of banks and credit unions.

Chairman McWilliams said in her written testimony, “The FDIC is also actively considering similar targeted adjustments to further mitigate unintended consequences resulting from pandemic-related Government programs.” I know that the Paycheck Protection Program and Economic Impact Payments in particular have resulted in significant cash-flow changes that have made financial institutions look temporarily much larger than normal for the purposes of their capital treatment. Are there other Government programs that have had a similar impact?

What specific adjustments are you considering as a result of these Government responses?

A.1. I am actively considering options that the agency can take to provide relief from rules that are tied to assets. Many of our credit unions have grown due to an unexpected high volume of deposits that has flowed into these credit unions.

At the NCUA’s November Board meeting, the Board approved a proposed rule change that would allow credit unions to capitalize interest when considering loan modifications for borrowers that have experienced financial distress. We believe this rule change would be particularly helpful for borrowers who have mortgages that have been in forbearance for an extended period of time.

In April 2020, the Board unanimously approved an interim final rule that amended the NCUA’s capital adequacy, member business loans, and commercial lending regulations following the creation of the Small Business Administration’s Paycheck Protection Program (PPP).

The interim rule amended the NCUA’s capital adequacy regulation so that covered PPP loans receive a zero-percent risk weight in the agency’s risk-based net worth requirements. In addition, if a PPP loan is pledged as collateral for a nonrecourse loan provided through the Federal Reserve System’s PPP Lending Facility, the pledged loan can be excluded from a federally insured credit union’s calculation of total assets for the purposes of calculating its net worth ratio.

Also in April 2020, the NCUA Board approved an interim final rule that enhanced the Central Liquidity Facility (CLF) regulations and supplemented legislative changes made by the Coronavirus Aid, Relief, and Economic Security (CARES) Act. This interim final rule:

- Eliminated the 6-month waiting period for a new member to receive a loan;
- Made temporary amendments to the waiting period for a federally insured credit union to terminate its membership;
- Eased collateral requirements on some assets; and
- Allows, temporarily, for an agent member to borrow for its own liquidity needs.

Besides announcing statutory and regulatory changes to the CLF, the NCUA also provided substantial guidance on the benefits of joining the CLF for both individual credit unions, and the credit union system as a whole.

In addition, the Board unanimously approved in April 2020, a temporary final rule that offers credit unions temporary regulatory

relief. This rule temporarily raised the maximum aggregate amount of loan participations that a federally insured credit union may purchase from a single originating lender without needing a waiver from their NCUA Regional Director.

Under the rule, a Federal credit union no longer has to refinance a purchased obligation so that it matches the types of loans the credit union is allowed to make. The final rule also suspended the required timeframes for the occupancy or disposal of properties held by Federal credit unions that are not being used to conduct business or that have been abandoned.

In May 2020, the Board also approved an interim final rule that made two temporary changes to the NCUA's prompt corrective action regulations that provide relief to credit unions that temporarily fall below well capitalized. This interim rule temporarily reduced the earnings retention requirement for credit unions classified as adequately capitalized. Those credit unions that cannot 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.

The NCUA provided more information on regulatory relief measures related to the agency's prompt corrective action regulations in a Letter to Credit Unions 20-CU-18, Prompt Corrective Action Regulatory Relief Measures in Response to the COVID-19 Pandemic (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/prompt-corrective-action-regulatory-relief-measures-response-covid-19-pandemic>). This was issued in anticipation that some credit unions may experience a temporary reduction in earnings and capital due to their COVID-19 response efforts. The letter describes the administrative order approved pursuant to § 702.201 that reduced the amount of earnings retention required for credit unions classified as adequately capitalized. Additionally, the letter describes credit unions' authority to submit a streamlined Net Worth Restoration Plan if their net worth ratio declined to undercapitalized predominantly due to temporary share growth as a result of the COVID-19 pandemic.

Also in the April 2020, NCUA Board meeting, the Board approved a final rule that increased the threshold level where an appraisal is not required for residential real estate-related transactions, from \$250,000 to \$400,000. This rule was communicated to credit unions in Letter to Credit Unions 20-CU-10, Residential Appraisals Threshold Increase and Other COVID-19 Related Relief Measures (<https://www.ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/residential-appraisals-threshold-increase-and-other-covid-19-related-relief-measures>). If the property involved in such a transaction falls below the threshold, federally insured credit unions will generally be required to obtain written estimates of the market value of the real estate, consistent with safe and sound practices. The final rule became effective upon publication in the *Federal Register* on April 30, 2020.

Further, the Board approved an interim final rule in the same April 2020, Board meeting that allows a federally insured credit

union to temporarily defer certain appraisals and evaluations for up to 120 days when alternatives are unavailable and when the appraisal or evaluation would delay the closing of the residential or commercial real estate loan transaction. This interim rule covers all real-estate related transactions except those for acquisition, development, and construction of real estate.

The NCUA Examiner's Guide was amended to include a COVID-19 chapter, which serves as a central source of guidance for examiners as they continue to work with credit unions during this pandemic. This chapter contains guidance specific to provisions of the CARES Act and relief measures approved by the NCUA Board that relate to the agency's examination program.

Through the NCUA's offsite examination stance, agency examiners are working to assist credit unions with the individual and unique challenges imposed by the COVID-19 pandemic. NCUA examiners consider the circumstances each credit union is facing when reviewing an institution's financial and operational conditions. The Examiner's Guide reiterates the NCUA's position that examiners will not criticize a credit union's prudent relief for members, provided it is conducted in a reasonable manner with proper controls and management oversight.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM RODNEY E. HOOD

Impact of Pandemic on Regulatory Asset Thresholds

Q.1. During the pandemic, because of participation in the Paycheck Protection Program, EIDL, EIP, USDA emergency programs, and others—as Chairman Crapo and Senator Toomey highlighted during the hearing—a number of financial institutions have grown to new regulatory thresholds, and for many this will be temporary.

I'm very proud of the work that community banks and credit unions in Montana have done to help their communities during this health and economic crisis, particularly the effort it has taken to make the Paycheck Protection Program work despite many challenges. I am concerned though that these community financial institutions will face unnecessary consequences from these important programs and may be unable to participate in future rounds of these stimulus programs.

Thank you to you all for your focus on the disproportionate impact that these increased assets have on smaller institutions. This is a problem I'm hearing about directly from Montanans, and like you we've seen that these pandemic-related assets have a more significant impact the smaller a bank is. Especially for these smaller banks, the problems with increased pandemic-related assets are not limited to PPP.

I know that this is something all of your agencies are looking into and some have taken action on. I appreciated hearing your answers to the Chairman's question, and I look forward to continuing to work with you all on this issue.

What can your agencies do to ensure financial institutions are not punished for participating in these programs while also maintaining the safety and soundness of the system?

A.1. I strongly support credit unions' efforts to assist their members through the use of various governmental programs intended for relief, especially during this pandemic. In response to the pandemic, and as a result of the CARES Act, the NCUA Board approved several measures to support credit unions by providing flexibility in regulatory asset thresholds.

In April 2020, the NCUA Board approved an interim final rule that amended the NCUA's capital adequacy (NCUA regulation part 702, Capital Adequacy, <https://www.ecfr.gov/current/title-12/chapter-VII/subchapter-A/part-702?toc=1>), and member business loans and commercial lending (NCUA regulation part 723, Member Business Loans; Commercial Lending, <https://www.ecfr.gov/current/title-12/chapter-VII/subchapter-A/part-723>) 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 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.

In May 2020, the NCUA Board approved an interim final rule that made two temporary changes to the NCUA's prompt corrective action (PCA) regulation (NCUA regulation part 702, Capital Adequacy) that provides relief to credit unions that temporarily fall below well capitalized.

The first change temporarily reduced the earnings retention requirement to zero for credit unions classified as adequately capitalized. PCA establishes the earnings retention requirement applicable to FICUs that are not well capitalized. This annual earnings retention requirement is a net worth amount equal to not less than 0.4 percent of their total assets. The NCUA Board used its authority to reduce the earnings retention requirement to ease the regulatory burden while maintaining safety in the system. The terms of the earnings retention requirement were issued in a separate administrative order in June 2020.

The second temporary change affects credit unions that experience a decline in their net worth ratio predominantly due to share growth. For these credit unions, the NCUA Board will temporarily permit the submission of a streamlined Net Worth Restoration Plan (NWRP). The streamlined NWRP must attest that:

- (1) The reduction in the credit union's net worth ratio to an undercapitalized (has a net worth ratio of 4 percent to 5.99 percent) classification was predominantly caused by share growth; and
- (2) Such share growth is a temporary condition caused by COVID-19.

In these cases, the FICU may submit a simplified NWRP noting that the FICU fell into the undercapitalized category because of share growth. If a credit union poses an undue risk to the Share Insurance Fund or exhibits material safety and soundness concerns, a formal earnings transfer waiver request may be required.

The NCUA is required by statute 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. Additionally, it is important to note that federally insured, State-chartered credit unions are not assessed an annual operating fee by the NCUA.

Q.2. Can you do this all on your own or are there areas that require action from Congress?

A.2. I have met with Members of Congress to discuss the importance of the CARES Act provisions and the need for extensions during the COVID-19 pandemic. I thank Congress for extending the CLF and TDR CARES Act provisions in the Consolidated Appropriations Act, 2021. These provisions, described below, are vital to ensuring recovery during the pandemic.

In April 2020, the NCUA Board approved an interim final rule that amended its CLF regulation (NCUA regulation part 725, National Credit Union Administration Central Liquidity Facility, <https://www.ecfr.gov/current/title-12/chapter-VII/subchapter-A/part-725>). The interim final rule provides credit unions greater access to liquidity to help credit unions remain operational throughout the crisis, makes it easier and more attractive for credit unions to join the CLF, and it includes several amendments to conform to the CARES Act. This rulemaking is set to expire on December 31, 2021. The Board is unable to extend this regulatory relief beyond what is included in the CARES Act and lengthened in the Consolidated Appropriations Act, 2021.

The statutory changes made by the CARES Act to the NCUA's CLF also provide credit unions with essential liquidity protection. As of December 4, 2020, the facility's borrowing authority stands at \$32.8 billion—an increase of \$22.3 billion since April—a direct result of the CARES Act. In total, 4,145 credit unions (or 80 percent) of all federally insured credit unions now have access to the CLF. Section 4016 of the CARES Act increased the maximum legal borrowing authority from 12 to 16 times the subscribed capital stock and provides CLF access to members of corporate credit unions.

The TDR provision in the CARES Act (Section 4013) has given credit unions additional flexibility to offer better workouts for borrowers experiencing difficulties than they could normally offer. As of September 2020, call reports show the industry is increasing their allowance accounts in anticipation of future loan losses. These improved loan arrangements have proven to be critical for countless borrowers who have lost income due to the COVID-19 pandemic.

Impact of Pandemic on Safety and Soundness

Q.3. This pandemic has had significant impacts on our economy and communities throughout the country.

As you continue examinations, what impact are you seeing these factors have on the banks and credit unions you regulate?

A.3. The pandemic is affecting credit unions and their members to varying degrees. The credit union industry has a long history of

assisting their members in times of need and the NCUA continues to encourage credit unions to work with affected members. Like other industries, credit unions adapted to changing working and economic environments; they have adapted well, as credit unions are generally open and serving their members during the pandemic.

Similar to the Great Recession, there was a flight to safety resulting in the credit union industry experiencing high share growth in 2020. Americans who have kept their jobs have increased their savings rates dramatically, and those who lost their jobs have been helped by income support from the CARES Act and the Consolidated Appropriations Act, 2021. Credit unions and other financial institutions have been entrusted with those savings. Over the last year, as shown in the NCUA Call Report data from September 30, 2019, and September 30, 2020, shares have grown nearly 26 percent and, as can be expected, assets grew by almost 20 percent. As a result, many credit unions saw a decline in their net worth ratio as asset growth outpaced net worth growth. The credit union industry saw a decline in net worth over the past year from 11.39 percent as of September 30, 2019, to 10.44 percent as of September 30, 2020. The industry as a whole, however, remains well capitalized and strong.

As credit unions continue to work with members, their strategic plans are changing. Credit unions are preparing for lower earnings resulting from low interest rates and higher provision for loan losses in response to credit issues. A significant share of auto and mortgage loans went into forbearance at the start of the crisis and many borrowers are still in this status. With elevated unemployment rates and the sharp impacts of the crisis on specific industries (for example, leisure and hospitality), the pandemic is affecting credit union members throughout the country and thus has increased credit risk.

Going forward, the industry will face not just increased credit risk, but will also have to deal with the prospect of compressed margins. When interest rates decline, as they have since February, there is a tendency for net interest margins (NIMs) to shrink. Although a downward trend in credit union NIMs has been evident for several decades, with historically low interest rates and little likelihood that they will rise materially anytime soon, credit unions are likely to find shrinking NIMs are a significant challenge. Additionally, as with banks, credit unions are offering relief to their members in the form of loan forbearance, which reduces earnings as the inflow of loan payments decreases during forbearance.

Q.4. Is this impact different on smaller, community institutions?

A.4. In general, credit unions tend to be relatively small institutions. The vast majority have less than \$1 billion in assets and all but a handful have less than \$10 billion in assets. Accordingly, the NCUA is nuanced when describing effects for credit unions of different sizes; by an absolute standard, almost all of our regulated institutions are modest in size.

In some ways, the impact of the pandemic on smaller credit unions (under \$50 million in assets) can be more severe than larger institutions. For example, a smaller credit union may find it more

difficult to serve remote members if they haven't invested in the latest technology. Smaller credit unions frequently serve a field of membership that is concentrated in one employer or industry. In relative terms, however, there are moderate increases in assets and shares among our smaller credit unions. Assets and shares have grown materially throughout the system, but larger credit unions have expanded their balance sheets the most.

It is still too early to make a reliable determination about whether credit risk at smaller credit unions has increased or decreased. Also, many other factors will affect a credit union's credit risk profile through the course of this crisis. Given the uneven effects of the crisis, much will depend on a credit union's field of membership, geographic footprint, and loan portfolio.

Large and small credit unions alike have seen their interest margins shrink. The latest data suggest that smaller credit unions may have seen slightly larger declines, but smaller credit unions tended to have higher interest margins prior to the crisis. It is difficult to predict whether the difference between interest margins at small and large credit unions will continue to shrink in the coming quarters. As of September 30, 2020, small credit unions remain strong and well capitalized (97 percent) with a net worth of approximately 16 percent, a slight decline from approximately 17 percent as of September 30, 2019. The reason for the decline is similar to the rest of the credit union industry—asset growth outpaced net worth growth, but to a smaller degree. Small credit unions also saw the impact of a flight to safety as shares grew in small credit unions by approximately 8 percent.

Risks in Financial System:

Q.5. For the past 8 months, much of everyone's focus has been on the health and economic crisis. But everything else hasn't stopped because of the coronavirus, even if at times it feels that way.

Are there trends that you are seeing or problems you are concerned about that we aren't focused enough on during the pandemic?

A.5. The NCUA continues to focus on its top pandemic-related priorities:

- (1) the health and safety of NCUA staff and contractors;
- (2) the impact on credit union operations; and
- (3) the impact on credit unions' financial condition.

In March 2020, the agency successfully transitioned to an offsite stance, enabling us to reduce the risk to staff while still performing our mission and essential functions. Additionally, the NCUA provided credit unions with guidance on operating during the pandemic and implemented regulatory relief where feasible.

Throughout the pandemic, in particular, increased telework and heavy leverage of information technology to support remote operations has increased cybersecurity risks, both in the broader financial services sector and in the credit union industry. Indeed, the NCUA has seen an increase in fraudulent activity, such as phishing, identity theft, and ransomware. In partnership with the Treasury Department, the FBI, and other agencies, the NCUA issued an August 2020 guidance letter that updated credit unions

about the fraud risks associated with operations under COVID-19. The agency continues to monitor developments in these areas.

While the anticipated adverse financial trends of COVID-19 have not yet fully materialized, the NCUA is also monitoring credit unions' cash, liquidity, loan delinquencies, loan losses, and loan forbearance programs. The agency has analyzed a range of outcomes and their impact on credit unions' net worth and the impact on the Share Insurance Fund to anticipate and prepare for a range of potential outcomes.

Post-Pandemic Economy

Q.6. As the pandemic continues our economy continues to suffer, and I am concerned that we will have another slow, uneven recovery like we saw after the most recent economic crisis. A concern I know many here share.

What are your top priorities to make sure that that doesn't happen?

A.6. I have been working diligently on a number of fronts to mitigate the impact that this pandemic has had on credit unions and their members, particularly those from underserved and lower-income communities. A good example is the recent Letter to Credit Unions 21-FCU-03, Underserved Area Expansions, <https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/underserved-area-expansions-0>. The credit union industry has a long history of assisting its member-owners in times of need, as we are experiencing right now. The NCUA supports credit unions' efforts 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.

To reflect the agency's response to the economic conditions that emerged in response to the COVID-19 pandemic, as well as various statutory and regulatory changes that occurred since March 2020, the NCUA updated its 2020 supervisory priorities in July 2020 in Letter to Credit Unions 20-CU-22, Update to NCUA's 2020 Supervisory Priorities, <https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/update-ncuas-2020-supervisory-priorities>. The update to the NCUA's supervisory priorities focused supervisory attention on:

- Consumer financial protection based on the potential for increased consumer compliance risk resulting from the COVID-19 pandemic's impact on consumers;
- Compliance with the applicable provisions outlined in the CARES Act;
- Credit risk management and allowance for loan and lease losses reviews in response to delays in the FASB requirement to comply with CECL;
- Liquidity risk reviews in light of the COVID-19 economic impact; and
- Information systems and assurance reviews using the newly deployed InTREx-CU tool. The InTREx-CU is a newly

deployed security tool to aid examiners and credit unions in finding and mitigating potential information security risks and program deficiencies.

The NCUA also provides grants and loans through the Community Development Revolving Loan Fund (CDRLF) program, which helps low-income-designated credit unions provide basic financial services to their members and stimulate economic activity in their communities. Early on in the pandemic, 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 to help them better serve their members and communities during the pandemic. Forty-eight of the credit unions receiving this assistance were Minority Depository Institutions (MDIs). Some of the funding took the form of rental, mortgage, and utility payment assistance to members, such as entrepreneurs, small business owners, and hospitality/service industry employees.

Looking forward, I believe that efforts to promote financial inclusion will be paramount in ensuring that our economic recovery is broad and evenly shared. At its core, 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. In short, these Americans are most at risk of being left behind in an economic recovery. Throughout my tenure, I have encouraged the NCUA to identify new and innovative ways to bring more Americans into the financial mainstream. To this end, I am pleased to report that the agency launched a new initiative in October called ACCESS, or Advancing Communities through Credit, Education, Stability, & Support, <https://ncua.gov/support-services/access>. 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. I often note that credit unions have a strong emphasis on service to their members—one that is captured in the industry’s “people helping people” ethos—which is exactly the mindset needed in the coming recovery.

Q.7. What more should Congress be doing to address the long-term implications of this crisis?

A.7. I believe Congress should focus on providing programs that alleviate the impact of the pandemic, such as the PPP and mortgage loan forbearance. Additionally, Congress should focus on ways to shorten the duration of the pandemic and get the economy back to normal by developing programs and protocols designed to provide a safe public and work environment.

I want to thank Congress for extending two important provisions of the CARES Act in the recent Consolidated Appropriations Act, 2021. First, the statutory changes made by Section 4016 of the CARES Act to the NCUA CLF provided credit unions with essential liquidity protection. As of December 4, 2020, the facility’s borrowing authority stands at \$32.8 billion—an increase of \$22.3 billion since April—a direct result of the CARES Act. In total, 4,145 credit unions (or 80 percent) of all federally insured credit unions

now have access to the CLF. Section 4016 of the CARES Act increased the maximum legal borrowing authority from 12 to 16 times the subscribed capital stock and provides CLF access to members of corporate credit unions.

Second, with the additional flexibility provided by the TDR language (Section 4013 of the CARES Act), 2,363 federally insured credit unions were able to make 1.7 million CARES Act forbearances totaling \$55 billion. In addition, credit unions have extended non-CARES Act loan modifications to their member-owners who experienced financial difficulties. The NCUA continues to encourage credit unions to make loan modifications to help those impacted by the pandemic.

Rural Branches

Q.8. I have long been concerned about consolidation among financial institutions. It's hard for small communities to survive without a post office and a bank or credit union branch.

Has the coronavirus pandemic changed trends you have been seeing in recent years around the closure of branches? Or mergers and acquisitions?

A.8. Addressing the needs of rural and smaller, potentially underserved communities is a passion of mine. I am a proud, native North Carolinian, where over one-third of the population lives in rural areas, and I have strong family ties to rural America. As you note, the trend of consolidation among financial institutions is a long-running trend. The credit union industry has not been immune from that trend, particularly smaller credit unions. Consolidations and mergers can have a disproportionately negative impact on smaller communities, as witnessed by the trend of many financial institutions, particularly banks, pulling out of rural America in the past few decades.

With their historical grounding as a comprehensive, member-owned system of affordable financial services for underserved groups, I believe that credit unions play an important role in maintaining a strong presence in smaller communities to support their economic development and access to capital. At the NCUA, I have worked to put the industry in a stronger position to do just that. In July, for instance, the NCUA Board unanimously approved a final rule (<https://ncua.gov/files/agenda-items/AG20200730Item1b.pdf>) that would help facilitate 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. This rule will help maintain and expand financial access to more Americans in smaller and underserved communities.

Early on in the pandemic, the NCUA committed the majority of its 2020 CDRLF allocation to COVID-19 assistance. The NCUA awarded \$3.7 million in grants and no-interest loans to 162 low-income credit unions in 40 States and the District of Columbia this year to help the industry better serve its members and communities, mostly rural and underserved. Forty-eight of the credit unions receiving this assistance were MDIs.

As we are still amidst the pandemic, it is difficult to state definitively how the crisis may be impacting branch closures or mergers

and acquisitions. I have received some early indications that credit union merger activity could increase, but the extent and durability of any such trend remains unknown. In recent years, I have seen an increasing trend in the number of branch closings in smaller credit unions—this trend continued in 2020. The rural area branch trends of all federally insured credit unions, however, are generally consistent with urban area branches, with growth in rural area branches outpacing growth in urban areas in recent months.

The changes in branch count by credit union asset size, however, shows there is a higher number of branch closures in smaller credit unions than in larger credit unions. During 2020, the trends also show an increase in the number of branch closures in credit unions with less than \$100 million in assets and in credit unions with assets of \$250 million–\$500 million.

While the number of credit unions closing branches has increased for some asset sizes during 2020, the number of credit union branches located in rural areas has actually improved over the last 18 months—increasing from 4,852 at the end of the first quarter of 2019 to 4,900 at the end of the third quarter of 2020.

Compared to prior years, the trends in credit union consolidation—consisting of mergers, liquidations, and purchases and assumptions—slowed during 2020. While the pandemic has likely impacted credit unions already experiencing operating challenges, the pandemic has not dramatically increased the number of consolidations. In 2017, there were 202 credit union mergers, compared to 2020 when there were an estimated 105 mergers.

Q.9. Is there more that should be done legislatively or through regulation to address branch closures?

A.9. The consolidations and branch closures do not appear to have had a negative impact on rural area credit union branches. The trends actually support some growth in credit union branches located in rural communities over the past 18 months. Currently, credit unions are required to notify the NCUA of closures in conjunction with a merger. Further, a merging credit union is required to obtain an affirmative vote from its membership prior to merger. Membership notification in this instance includes a list of continuing credit union branch service locations, so members are aware of any proposed changes in the branch structure prior to voting to merge. The continuing credit union is also required to identify alternative means of service to members when closing a branch in conjunction with a merger.

The NCUA acts to minimize interruption in services to members in accordance with the Federal Credit Union Act; however, it does not have any further regulatory requirements pertaining to a credit union's decision to close a branch.

As noted, there are a number of valid reasons for closing a branch, and many of them involve normal operating decisions and cost structure analysis.

**RESPONSES TO WRITTEN QUESTIONS OF
SENATOR CORTEZ MASTO FROM RODNEY E. HOOD**

Q.1. Do you pledge to work with President-elect Biden's team to ensure an orderly transition to a new Administration?

A.1. Yes. The NCUA has collaborated with the President-elect's transition team since November 2020 following ascertainment.

Q.2. Have you established office space within your agency for the President-elect's transition team?

A.2. Yes. The agency will provide office space within the agency for the transition team, if requested.

Q.3. Have you prepared briefing books for the President-elect's transition team that includes all relevant information they will need to know?

A.3. Yes. All relevant briefing information has been provided to the transition team.

Q.4. Previously, you stated that the NCUA would consider TDR on a case-by-case basis. What has been the demand by credit unions for lower capital requirements due to delinquent loans?

A.4. The NCUA will continue to work with the other banking regulators to issue TDR guidance as needed and in accordance with Generally Accepted Accounting Principles (GAAP). The NCUA has not received requests to lower capital requirements due to delinquent loans. As of September 30, 2020, the delinquency ratio for federally insured credit unions remains low at 0.55 percent.

Q.5. Will your agency update the interagency guidance regarding Troubled Debt Restructuring to allow these COVID-19 loan modifications to extend beyond 6 months? Would loans with terms beyond 6 months still fall within the TDR authority?

A.5. The Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised) published on April 7, 2020, (<https://www.ncua.gov/files/press-releases-news/interagency-statement-tdr-policy-revised.pdf>), is still relevant and can be applied to modifications during 2021. This guidance states that subsequent modifications should be viewed in totality in determining if the additional modification is a TDR. The agencies, in consultation with the FASB, have stated short-term modifications (less than 6 months) are generally not considered a TDR. In particular, the guidance explains the requirements for a modification to be considered as a TDR and what should be done in the cases of loan modifications that are not considered to be TDRs. Any change to current GAAP would require FASB to make that change.

**RESPONSE TO WRITTEN QUESTION OF SENATOR SINEMA
FROM RODNEY E. HOOD**

Q.1. As you know, the commercial real estate (CRE) market is under extreme pressure due to this pandemic. Collapse of this market would be disastrous to Arizona communities. In April, the regulators released the "Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus." This guidance allowed financial institutions to modify existing CRE loans impacted by the coronavirus. While this guidance was helpful and much-needed, it now requires updating. Are there plans to update this guidance to allow these COVID loan modifications to extend beyond 6 months?

A.1. The Interagency Statement on Loan Modifications and Reporting for Financial Institutions Working with Customers Affected by the Coronavirus (Revised), (<https://www.ncua.gov/files/press-releases-news/interagency-statement-tdr-policy-revised.pdf>), is still relevant and can be applied to modifications during 2021. Nothing in the guidance precludes a financial institution from modifying a loan term beyond 6 months.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD



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99 M Street SE
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November 10, 2020

The Honorable Mike Crapo
 Chairman
 Committee on Banking, Housing and Urban Affairs
 United States Senate
 Washington, DC 20510

The Honorable Sherrod Brown
 Ranking Member
 Committee on Banking, Housing, and Urban Affairs
 United States Senate
 Washington, DC 20510

Dear Chairman Crapo and Ranking Member Brown:

On behalf of America's credit unions, I am writing to express our views ahead of the hearing entitled, "Oversight of Financial Regulators." 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 Their 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 being able to serve 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 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 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 in 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 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.

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

¹ 85 Fed. Reg. 23,212, 23,214 n.18 (Apr. 27, 2020).

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>.

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.

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.

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(e)(7)(ii)(A)(6).

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);
- provides temporary flexibility to NCUA to offer forbearance from PCA requirements;
- simplifies the PPP loan forgiveness process; and
- exempts Member Business Loans (MBL) during and for one year after the National Emergency.

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. 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.

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.

Credit unions want to help as many Americans as possible. Under the CARES Act, credit unions are required treat members with Federally backed loans in a certain way, and they have been doing that. But it's critically important to extend that same accommodation to other borrowers who need it. We need consistency in how consumers are treated.

We urge Congress to extend the CARES Act's temporary TDR relief for an additional year, until the end of 2021.

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. 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.

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 that it can be prepared to help credit unions in future crises.

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.⁷ 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 you 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 Small Business Administration's (SBA) 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 lead 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 S. 4117, introduced by Senators Cramer, Menendez, Tillis, and Sinema. 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.

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.

⁷ 12 U.S.C. § 1790d(c).

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.⁸

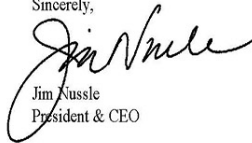
Additional credit union lending will not impede bank lending activity. SBA research shows that growth in credit unions' small business lending is apparent in many respects but a majority of credit union business lending is for loans that banks will not originate—which means a majority of credit union lending does not replace lending that would otherwise be done by banks—it is lending that otherwise would not occur.⁹ 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, we encourage the Committee to support S. 3676 and its House companion H.R. 6789, the Access to Credit for Small Businesses Impacted by the COVID-19 Crisis Act of 2020. These bills would lift the credit union MBL cap during the pandemic and one-year after the pandemic has been declared over for loans specific to COVID-19.

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

⁸ 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).

⁹ Wilcox, James A., The Increasing Importance of Credit Unions in Small Business Lending. Small Business Administration Office of Advocacy (2011).



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National Association of Federally-Insured Credit Unions

November 9, 2020

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing
& Urban Affairs
United States Senate
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing
& Urban Affairs
United States Senate
Washington, DC 20510

Re: Tomorrow's Hearing on "Oversight of Financial Regulators"

Dear Chairman Crapo and Ranking Member Brown:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts ahead of Tuesday's hearing, "Oversight of Financial Regulators." 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 tomorrow's 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) 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.
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.

The Honorable Mike Crapo, The Honorable Sherrod Brown
November 9, 2020
Page 2 of 3

NAFCU outlined these requests in more detail in a [letter to the NCUA earlier today](#).

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.

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 Chairman Crapo's request that the NCUA extend troubled debt restructuring (TDR) relief, such as that found in the CARES Act, to January 1, 2022. Additionally, we support extending the relief provided in the CARES Act that makes changes to the NCUA's Central Liquidity Facility (CLF) beyond December 31, 2020. As credit unions continue to help their members through this unprecedented time, this change would provide important relief that will ultimately benefit credit union members until certain loans are able to perform in normal circumstances.

NAFCU supports the many legislative efforts that Senators have 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.

The Honorable Mike Crapo, The Honorable Sherrod Brown
November 9, 2020
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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
Vice President of Legislative Affairs

cc: Members of the Senate Banking Committee



Supervision and Regulation Report

November 2020



Supervision and Regulation Report

November 2020

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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.

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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).

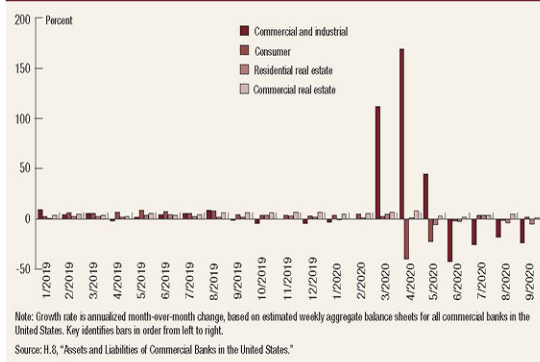
Banks also took a number of actions to maintain financial and operational resiliency. As a result, capital levels remain robust—indeed, they have actually increased during the COVID event—aided by timely policy response and capital preservation measures. Despite operational challenges, both banks and 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)



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

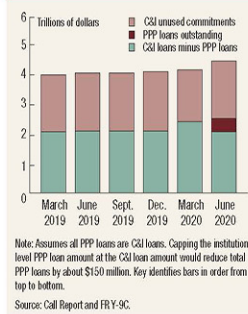
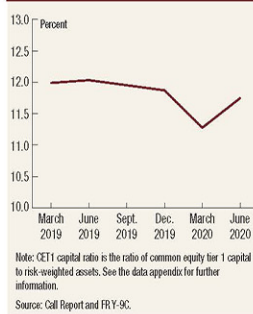
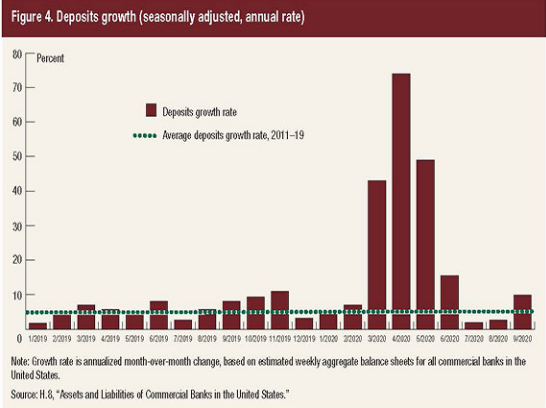


Figure 3. Aggregate common equity tier 1 (CET1) capital ratio





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).



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.

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 7. Nonperforming loan ratio

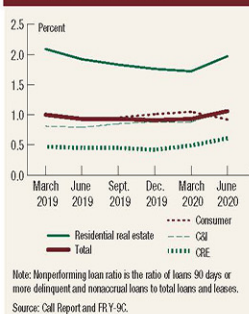
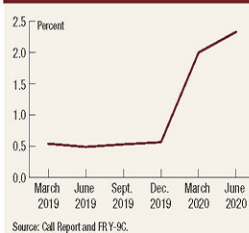


Figure 8. Provisions to average loans and leases (annual rate)



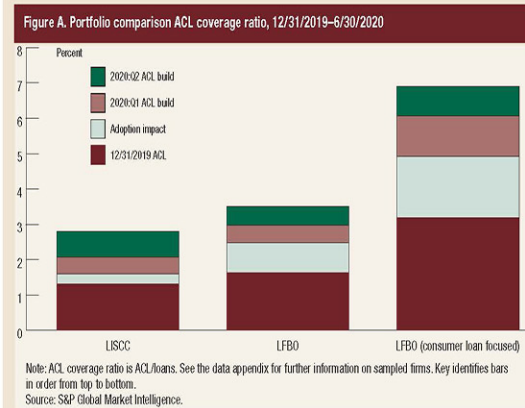
⁵ See SR Letter 20-18/CA 20-13 “Joint Statement on Additional Loan Accommodations Related to COVID-19” at <https://www.federalreserve.gov/supervisionreg/srletters/SR2018.htm>.

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,



(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.

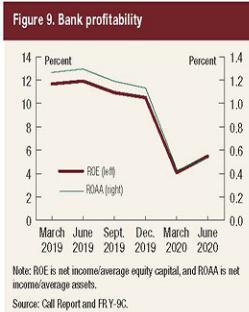
Federal Reserve supervisors will continue to conduct examinations of CECL implementation at large state member banks during the second half of 2020. Supervisors have focused on CECL modeling approaches, qualitative adjustments, and documentation of reserving practices. Supervisors will continue to monitor 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.



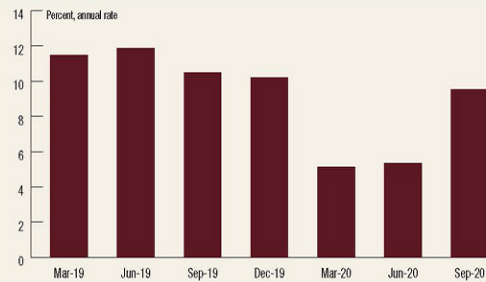
Box 2. Third-Quarter Earnings at a Sample of Large Banks

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.

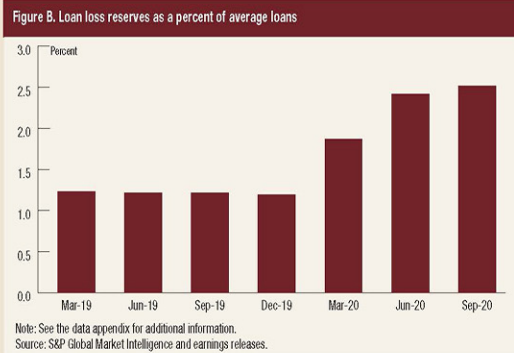
Pressure on Net Revenue

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.

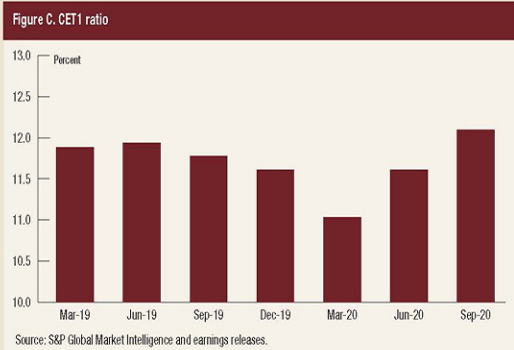
Box 2. Third-Quarter Earnings at a Sample of Large Banks—continued



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.



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. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191002a.htm |
| 10/8/2019 | Agencies finalize changes to simplify Volcker rule proprietary trading regulations. Interagency press release: 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. Federal Reserve Board press release: 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. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/other20191017a.htm |
| 10/18/2019 | FDIC and Federal Reserve request information on use and impact of CAMELS ratings. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191018a.htm |
| 10/28/2019 | Agencies propose rule to amend swap margin rules. Interagency press release: 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. Interagency press release: 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. Interagency press release: 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. Federal Reserve Board press release: 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. Interagency press release: 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. Interagency press release: 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. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191119c.htm |
| 12/3/2019 | Agencies clarify requirements for providing financial services to hemp-related businesses. Interagency press release: 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. Federal Reserve Board press release: 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. Federal Reserve Board press release: 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. Interagency press release: 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. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200130a.htm |
| 1/30/2020 | Agencies propose changes to modify Volcker rule "covered funds" restrictions. Interagency press release: 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. Federal Reserve Board press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm |
| 3/6/2020 | Agencies invite comment on updates to resolution plan guidance for large foreign banks. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200306b.htm |

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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. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200309a.htm |
| 3/10/2020 | SR 20-3 / CA 20-2 Interagency Statement on Pandemic Planning. 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. 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. Interagency press release: 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. Federal Reserve Board press release: 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. FFIEC press release: 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. Interagency press release: 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. https://www.federalreserve.gov/supervisionreg/srletters/SR2008.htm |
| 4/6/2020 | Agencies announce changes to the community bank leverage ratio. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200406a.htm |
| 4/6/2020 | SR 20-10 Small Business Administration (SBA) and Treasury Small Business Loan Programs. 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). Interagency press release: 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. https://www.federalreserve.gov/supervisionreg/srletters/SR2011.htm |
| 4/17/2020 | Federal Reserve adopts a change in Regulation D 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. Federal Reserve Board press release: 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. Interagency press release: 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. FFIEC press release: 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. Federal Reserve Board press release: 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. Interagency press release: 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. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200508a.htm |
| 5/8/2020 | SR 20-12 Interagency Policy Statement on Allowances for Credit Losses: https://www.federalreserve.gov/supervisionreg/letters/SR2012.htm |
| 5/8/2020 | SR 20-13 Interagency Guidance on Credit Risk Review Systems: https://www.federalreserve.gov/supervisionreg/letters/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. Interagency press release: 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. Interagency press release: 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. Federal Reserve Board press release: 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. Interagency press release: 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: https://www.federalreserve.gov/supervisionreg/letters/sr2015.htm |
| 6/24/2020 | SR 20-16 Supervision of De Novo State Member Banks: https://www.federalreserve.gov/supervisionreg/letters/SR2016.htm |
| 6/25/2020 | Financial regulators modify provisions of Volcker rule related to "covered funds." Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm |
| 6/25/2020 | Agencies finalize amendments to swap margin rule. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625b.htm |
| 7/1/2020 | Agencies provide largest firms with information for next resolution plans. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200701a.htm |
| 7/1/2020 | Financial regulators issue statement on managing the LIBOR transition. FFIEC press release: https://www.ffiec.gov/press/p070120.htm |

(continued)

Table 1.—continued

| Date issued | Rule/guidance |
|-------------|---|
| 7/15/2020 | <p><i>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.</i> <i>Federal Reserve Board press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200715a.htm</p> |
| 8/3/2020 | <p><i>SR 20-18 / CA 20-13 Joint Statement on Additional Loan Accommodations Related to COVID-19:</i> https://www.federalreserve.gov/supervisionreg/letters/SR2018.htm</p> |
| 8/21/2020 | <p><i>SR 20-21 Joint Statement on Bank Secrecy Act Due Diligence Requirements for Customers Who May Be Considered Politically Exposed Persons:</i> https://www.federalreserve.gov/supervisionreg/letters/SR2021.htm</p> |
| 8/26/2020 | <p><i>Agencies issue three final rules:</i></p> <ul style="list-style-type: none"> • <i>a final rule that temporarily modifies the community bank leverage ratio, as required by the CARES Act;</i> • <i>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</i> • <i>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.</i> <p><i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200826a.htm</p> |
| 9/1/2020 | <p><i>Federal and state financial regulatory agencies issue interagency statement on supervisory practices regarding financial institutions affected by Hurricane Laura and California wildfires.</i> <i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200901b.htm</p> |
| 9/21/2020 | <p><i>The Federal Reserve Board issued an Advance Notice of Proposed Rulemaking to modernize the regulations to implement the Community Reinvestment Act.</i> <i>Federal Reserve Board press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm</p> |
| 9/29/2020 | <p><i>Agencies issue two final rules:</i></p> <ul style="list-style-type: none"> • <i>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;</i> • <i>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.</i> <p><i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200929a.htm</p> |
| 9/30/2020 | <p><i>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.</i> <i>Federal Reserve Board press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930a.htm</p> |
| 10/9/2020 | <p><i>SR 20-22 ISDA IBOR Fallback Protocol and IBOR Fallback Supplement:</i> https://www.federalreserve.gov/supervisionreg/letters/SR2022.htm</p> |
| 10/9/2020 | <p><i>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:</i> https://www.federalreserve.gov/supervisionreg/letters/SR2023.htm</p> |
| 10/20/2020 | <p><i>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.</i> <i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020b.htm</p> |
| 10/20/2020 | <p><i>The federal banking agencies finalized a rule to limit the interconnectedness and reduce the impact from failure of the largest banking organizations.</i> <i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020a.htm</p> |
| 10/23/2020 | <p><i>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.</i> <i>Interagency press release:</i> https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201023a.htm</p> |

(continued)

Table 1.—*continued*

| Date issued | Rule/guidance |
|-------------|---|
| 10/29/2020 | Agencies propose regulation on the role of supervisory guidance. Interagency press release: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201029a.htm |
| 10/30/2020 | Agencies release paper on operational resilience. Interagency press release: 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.

| Portfolio | Definition | Number of institutions | Total assets (\$trillions) |
|--|---|-----------------------------|----------------------------|
| Large Institution Supervision Coordinating Committee (LISCC) | Eight U.S. global systemically 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 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, FRY-70, FRY-9C, FRY-SSP, 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

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

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 U.S. G-SIBs | Category II ≥\$700b total assets or ≥\$75b in cross- jurisdictional activity | Category III ≥\$250b total assets or ≥\$75b in NBA, wSTWF, or off-balance-sheet exposure | Category IV Other firms with \$100b to \$250b total assets |
|---|--|--|---|--|
| Domestic firms | | | | |
| U.S. domestic banking organization | Bank of America Bank of New York Mellon Citigroup Goldman Sachs JPMorgan Chase Morgan Stanley State Street Wells Fargo | Northern Trust | Capital One Charles Schwab PNC Financial U.S. Bancorp Truist Financial | Ally Financial American Express Citizens Financial Discover Fifth Third Huntington KeyCorp M&T Bank Regions Financial Synchrony Financial |
| Foreign firms (standards vary by legal entity) | | | | |
| Intermediate holding company | | | Barclays US Credit Suisse USA Deutsche Bank USA DWS USA HSBC North America TD Group US UBS Americas | BMO Financial BNP Paribas USA MUFG Americas RBC US Santander Holdings USA |
| Combined U.S. operations | | Barclays Credit Suisse Deutsche Bank MUFG Sumitomo Mitsui | Bank of Montreal BNP Paribas HSBC Mizuho Toronto-Dominion UBS | Banco Santander Bank of Nova Scotia BBVA BPCE Société Générale 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 filings¹⁷ 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; Trust 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.

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) examina-

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

tions 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.

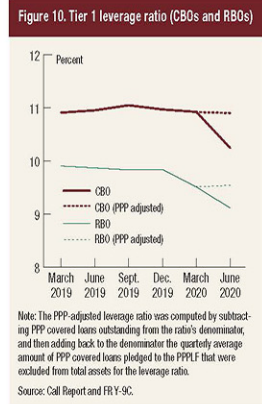
Community and Regional Banking Organizations

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.



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/letters/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 (PPF) in 2008 to improve coordination of support to state-member MDIs.² The PPF 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 PPF-dedicated staff at each of the 12 Federal Reserve Banks oversee and coordinate the PPF activities.

In response to the COVID event, the Federal Reserve conducted several PPF 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 PPF, see the Federal Reserve Board's website at <https://fdpartnership.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 LISC 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 non-residential 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 LISSC (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 Losses 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 |

