# OVERSIGHT OF PRUDENTIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, DIVERSITY, AND ACCOUNTABILITY OF DEPOSITORY INSTITUTIONS

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HOUSE COMMITTEE ON FINANCIAL SERVICES

MAXINE WATERS, California, *Chairwoman*

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**Wednesday, May 19, 2021**

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The committee met, pursuant to notice, at 10:04 a.m., via Webex, Hon. Maxine Waters [chairwoman of the committee] presiding.

Members present: Representatives Waters, Maloney, Velazquez, Sherman, Meeks, Scott, Green, Cleaver, Perlmutter, Himes, Foster, Vargas, Gottheimer, Lawson, Axne, Casten, Torres, Lynch, Adams, Tlaib, Dean, Garcia of Illinois, Garcia of Texas, Williams of Georgia, Auchincloss; McHenry, Lucas, Posey, Luetkemeyer, Huizenga, Stivers, Wagner, Barr, Williams of Texas, Hill, Emmer, Zeldin, Loudermilk, Mooney, Davidson, Budd, Kustoff, Hollingsworth, Gonzalez of Ohio, Rose, Steil, Gooden, and Timmons.

Chairwoman WATERS. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

As a reminder, I ask all Members to keep themselves muted when they are not being recognized by the Chair. The staff has been instructed not to mute Members, except when a Member is not being recognized by the Chair and there is inadvertent background noise.

Members are also reminded that they may only participate in one remote proceeding at a time. If you are participating today, please keep your camera on, and if you choose to attend a different remote proceeding, please turn your camera off.

Before we begin today's hearing, I would like to take a moment to congratulate Representative Jake Auchincloss, who has recently been elected by committee Democrats to serve as the committee's Vice Chair for this Congress. Mr. Auchincloss has dedicated his career to public service, having served in the Marines and then as a three-term city councilman in Newton, Massachusetts. I know he shares my passion for affordable housing, and I have been very impressed with his level of engagement and thoughtfulness on committee issues. So, I am pleased that he will be serving, as of next week, as the committee's Vice Chair, and I look forward to working with him in his new role.

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

Welcome, Chairman Harper and Acting Comptroller Hsu, and welcome back, Chairman McWilliams and Vice Chairman Quarles. A major focus of this committee continues to be the economic impacts of the COVID-19 pandemic crisis. Today, I expect to hear from our witnesses about what their agencies are doing to respond to this ongoing crisis and that they are going to make sure that banks and credit unions are not further harming consumers, especially people of color who are already facing challenges through no fault of their own as a result of the pandemic, and that those institutions are, instead, helping consumers and supporting the recovery of communities and people of color whenever possible.

I have long been critical of the long list of harmful deregulatory actions taken by the last Administration's appointees, and, particularly, their actions to roll back key Dodd-Frank Act reforms and other consumer protections. So, I am pleased that the Senate has taken bipartisan action to reverse the OCC's so-called True Lender Rule which would allow non-bank lenders to skirt State interest rate protections, and I have called on House leadership to take up that Congressional Review Act resolution as soon as possible.

I am also pleased that the Biden Administration's appointees are bringing a better approach to regulation that prioritizes consumers, and that regulators are starting to take steps to protect the financial stability of our system against climate risk and other threats.

Vice Chair Quarles, I am alarmed by reports that the Fed is planning to weaken its bank merger review process, one that already amounts to a rubber-stamping process. Additionally, Fed Governor Brainard has expressed concerns about concentration in the $250 billion to $700 billion asset size category. And I would note that this should not be surprising, given the various rollbacks we have seen on large bank capital, liquidity, and other safeguards. Regulators must reverse course immediately to promote financial stability, so I look forward to hearing about what prudential regulators are doing about banking deserts, where bank branches have closed, leaving communities with less access to traditional banking services.

I was pleased to learn that the OCC, under Acting Comptroller Hsu's leadership, announced yesterday that they are reconsidering Joseph Otting's harmful Community Reinvestment Act (CRA) rule. Modern-day redlining has left communities of color with limited access to much-needed financial services, so policymakers must act with urgency to address these issues.

I am also eager to hear from the members of the panel regarding their Agency's efforts on diversity and inclusion in the banking sector, including their work to support Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs) during this pandemic.

Lastly, I want to make clear that temporary regulated exemptions or delays for banks that were put in place for the pandemic must come to an end and be allowed to expire. The previous Administration attempted to use the pandemic as a cover to delay or weaken key financial safeguards and regulations, and those efforts must not be allowed to stand.

I want to thank you, and I look forward to the testimony from all of our witnesses. And I will now recognize the ranking member of the committee, the gentleman from North Carolina, Mr. McHenry.

Mr. MCHENRY. Thank you, Madam Chairwoman. I would like to start by welcoming the regulators back today, some familiar faces and some new. Chair McWilliams, Vice Chair Quarles, I would like to, again, thank you for your work throughout the pandemic to ensure our financial system remained strong. Your quick and decisive actions to provide appropriate flexibility for financial institutions and consumers set up for us a very strong economic rebound here in the United States.

Mr. Hsu, I also want to welcome you to the committee in your new role as Acting Comptroller of the Currency. However, I think it is safe to say that many of us expected to hear from a confirmed Comptroller of the Currency at this point. There has been a lot of speculation about who President Biden's nominee will be. It seems to be a Goldilocks approach here. First, Michael Barr was deemed too conservative, if you can call somebody who helped write Dodd-Frank a conservative. I don't think so. Then, Mehrsa Baradaran, who advocates for socialized banking and opposes innovation, well, she seemed to appease the far left progressives, but still no formal nomination. So, we are left to wonder who will be deemed as, "safe and sound," at least in the eyes of President Biden, to permanently fill the role.

But indecision has real-world consequences. As President Biden tries to cater to his party's political whims at the OCC, our financial institutions are left without a clear path forward. That is problematic. Former Comptroller Otting and former Acting Comptroller Brooks made great strides in a nonpartisan, nonideological way to remove regulatory roadblocks and to support financial inclusion through innovation. But now, these positive steps forward are stuck in limbo, or worse, in danger of being scrapped altogether for political optics.

This is not the right way to regulate, but I fear this is just the start of the Democrats' one-party-rule mentality in practice. We know that Democrats' tendency is to overregulate when they feel like they need to do something. We saw this in 2009 and 2010 with Dodd-Frank, and we know the negative impact it had on our financial institutions and our economy. We are already seeing Democrats treat the COVID pandemic just like the financial crisis, but the two are not comparable, and our economy is in a much different place now.

What my Democrat colleagues should take away from the pandemic is that outsized regulation is problematic, and that financial technology plays a really important role in our day-to-day lives and should be embraced. We should use advances in technology to help bring more unbanked and underbanked Americans into the fold and to close banking deserts, just as the Chair says.

The OCC, and the FDIC under Chair McWilliams, worked to address the overly-burdensome mandates that hindered financial technology by issuing rules to address the so-called valid-when-made doctrine. That was positive and helpful to our economy. The OCC also moved to finalize its True Lender Rule, creating a much-needed framework for providing affordable credit to all consumers, particularly those who need it most, through banks and non-banks. Together, these rules helped bring more Americans under the banking umbrella. That is good. We should build on these gains rather than trying to re-litigate 2009. I don't think that is the right approach. So, I look forward to hearing from each of you on how we can best accomplish that.

Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you very much.

Mr. PERLMUTTER. Madam Chairwoman, you muted yourself. Did you recognize me?

Chairwoman WATERS. Yes, Mr. Perlmutter. You are now recognized for one minute.

Mr. PERLMUTTER. Thank you very much, and I want to thank our witnesses for appearing today, and thank you for your service to the United States of America.

The pandemic served as the ultimate stress test for the financial system, and I believe, unlike my friend from North Carolina, that it demonstrated how important Dodd-Frank is for the stability of our economy. Capital liquidity and other regulatory requirements we require of financial institutions helped to weather a period of historic uncertainty and fear, but I would caution that we are not out of the storm yet. Many families are struggling to find childcare as parents reenter the workforce. Supply chain disruptions have slowed outputs, and we still need to get more Americans vaccinated. Meanwhile, there has been some volatility and recklessness in the financial markets. Multiple banks just lost billions by allowing Archegos to gamble with their money. Retail traders are battling hedge funds over GameStop, and a $75 billion cryptocurrency's value fluctuates based on, "Saturday Night Live" guest performances.

Maintaining stability in our financial sector is critical to a strong and far-reaching recovery, and I urge all of our witnesses today to keep a close eye on their supervised firms to ensure that operations of banks and credit unions are safe and sound. I look forward to the discussion today, and I yield back.

Chairwoman WATERS. I now recognize the gentleman from Missouri, Mr. Luetkemeyer, for one minute.

Mr. LUETKEMEYER. Thank you, Madam Chairwoman. I thank all of the witnesses for being here as well today, and the four of you are testifying at a very interesting time in our economy and within the banking system. As the economy is set to recover from the pandemic, I have a number of concerns. The enormous stimulus bill recently passed and continued unemployment benefits have created threats of inflation in an environment where small businesses cannot find workers.

Throughout the pandemic, banks have been providing forbearance to customers to ensure that they can make it through the pandemic. As much of this forbearance is set to expire, it is critical that we examine how regulators will treat these assets going forward. The rise of fintechs has raised specific questions on the chartering of financial institutions, the identity of the true lender of a loan, and whether these entities should be regulated on a Federal level. Banking regulations are also shifting with a focus on risk mitigation related to climate risk, which, if unchecked, could result in a choke-point style impact on legally-operating companies in the energy sector.

These are just a few of the issues I look forward to discussing with you today. And with that, Madam Chairwoman, I yield back.

Chairwoman WATERS. Thank you. It is now time to welcome today's distinguished witnesses to the committee. First, we have the Honorable Todd Harper, the Chairman of the National Credit Union Administration. And I understand that today happens to be Mr. Harper's birthday, so I want to take a moment to say happy birthday, and to thank you for being with us on your very special day. I hope this isn't the only celebration you are planning for today.

Second, we have Mr. Michael Hsu, the Acting Comptroller of the Currency. Third, we have the Honorable Jelena McAdams, the Chair of the Federal Deposit Insurance Corporation. And last, we have the Honorable Randal Quarles, the Vice Chairman of Supervision for the Board of Governors of the Federal Reserve System.

Each of you will have 5 minutes to summarize your testimony. You should be able to see a timer on your screen that will indicate how much time you have left, and a chime will go off at the end of your time. I would ask you to be mindful of the timer and quickly wrap up your testimony if you hear the chime.

And without objection, your written statements will be made a part of the record.

Mr. Harper, you are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE M. TODD HARPER, CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION (NCUA)**

Mr. HARPER. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for inviting me to discuss the credit union industry's performance and NCUA's operations. As a former Hill staffer who spent more than a decade working for this committee, I am deeply honored to join you today.

Despite the COVID-19 pandemic's many economic blows, the overall credit union system has remained on a solid footing with strong capital levels and sufficient liquidity. If past recessions are indicative, it seems likely that credit union performance will trail any labor market improvements by up to 2 years. The NCUA and credit unions should, therefore, prepare for that eventuality. Once forbearance programs expire, we will likely experience decreases in credit quality and increases in delinquencies and charge-offs, which will affect credit union financial statements, and, if failures occur, could impact the Share Insurance Fund.

Tragically, the pandemic has disproportionately affected low-income households, communities of color, and minority-owned businesses. The NCUA has encouraged credit unions to work with members experiencing hardship. The NCUA has also instructed examiners to refrain from criticizing a credit union's efforts to provide prudent relief for members. Through the Community Development Revolving Loan Fund, the NCUA is supporting low-income credit unions during these uncertain times. Although relatively small, these grants and loans make a big difference. In all, the NCUA awarded $3.7 million last year to 162 credit unions to assist in their pandemic response efforts. Although many more applied for a grant, the Agency could not fund the demand because of limited appropriations.

The pandemic has also prompted a heightened cybersecurity stance at our Agency. As part of the larger government-wide effort, the NCUA will continue bolstering its cybersecurity posture and provide guidance and resources to assist credit unions with strengthening their cyber defenses, including grants, and completing a pilot project to harmonize IT and cybersecurity exam procedures.

The NCUA is further working to strengthen its Consumer Financial Protection Program to ensure fair and equitable access to credit. This year, there is an increased emphasis on fair lending compliance, and Agency staff are studying methods for improving consumer financial protection supervision for the largest credit unions not primarily supervised by the Consumer Financial Protection Bureau (CFPB). Additionally, since opening its Office of Minority and Women Inclusion (OMWI) a decade ago, the Agency has made steady progress in advancing diversity. Last year, 2 out of every 5 new hires at the NCUA were people of color, and the Agency achieved parity and executive gender diversity. The NCUA will continue to invest in diversity and inclusion by enhancing support from minority depository institutions and fostering initiatives that close the wealth gap. These efforts will advance economic equity and justice within the system and ensure a more equitable recovery.

Finally, I want to highlight three areas where legislative action would aid the Agency in fulfilling its mission. First, the Financial Stability Oversight Council (FSOC), the Government Accountability Office (GAO), and the NCUA's inspector general have each called for the NCUA to have examination and enforcement authority over third-party vendors. The continued transfer of operations to credit union service organizations and other third parties diminishes the NCUA's ability to assess risks within the system, leaving thousands of credit unions, millions of their members, and billions of dollars in assets potentially exposed to unnecessary risks. Congress should close this growing regulatory blind spot.

Second, Congress should provide the NCUA with greater authority to proactively manage the Share Insurance Fund. Adopting a countercyclical approach to charging premiums would allow for an increase in insurance reserves during economic upturns to cover losses during downturns.

And third, Congress should permanently adopt the temporary enhancements granted to the NCUA's Central Liquidity Facility (CLF) in the CARES Act. Because of these reforms, the CLF's borrowing capacity has grown greatly, and 4 out of every 5 credit unions now have access to liquidity if other sources freeze up. Permanence will strengthen the shock absorbers for future liquidity events. We will provide the committee with more information on each of these matters in the coming weeks.

In conclusion, the NCUA remains focused on addressing the needs and best interests of credit union members, ensuring the safety and soundness of credit unions, and protecting the Share Insurance Fund. I look forward to working with the committee in support of these endeavors. Thank you.

[The prepared statement of Mr. Harper can be found on page 62 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Harper.

Next, we will go to Mr. Hsu. You are now recognized for 5 minutes to present your oral testimony.

**STATEMENT OF THE HONORABLE MICHAEL J. HSU, ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY (OCC)**

Mr. HSU. Chairwoman Waters, Ranking Member McHenry, members of the committee, thank you for the opportunity to testify today. I am honored by Secretary Yellen's confidence to appoint me to this post of Acting Comptroller of the Currency.

I am a career public servant and a bank supervisor at my core. During my 19 years of experience in multiple agencies, I have seen periods of growth, crisis, reform, and recovery. I have seen benefits that financial innovation and competition can bring, as well as the harm that excessive risk taking can inflict on families, businesses, and the economy.

My written testimony shares in more detail my priorities in the review of key regulatory actions that I initiated upon taking office. I see four urgent problems requiring immediate attention: first, guarding against complacency; second, reducing inequality; third, adapting to digitalization; and fourth, acting on climate change. Let me briefly describe each.

First, I believe the banking system is at risk of becoming complacent, especially the large banks. Banks deserve credit for weathering the pandemic well. I am concerned, however, that as the economy recovers and pressure to grow returns, overconfidence leading to complacency is a risk when prudent risk management is set aside in pursuit of profit. I see the losses related to Archegos primarily through this lens as reflective of the broader environment. This requires bank leaders, boards of directors, and us as supervisors to be especially vigilant.

Second, reducing inequality must be a national priority. As the recently-published Survey of Household Economics and Decisionmaking (SHED) report from the Federal Reserve shows, the pandemic has had a disproportionate impact on vulnerable groups, especially minority households and businesses. The recovery threatens to leave them, and rural communities, even further behind. Historically, many low-income individuals have been treated by banks as credits to be avoided or credits to be exploited. The OCC can help address that problem. We must work to strengthen regulations, in implementing the Community Reinvestment Act. I have asked staff to review the OCC's 2020 final rule. All options are under consideration, including rescinding or substantially revising it and working with the Federal Reserve and the FDIC on a joint proposal.

We must also use all of our supervisory tools to ensure that banks comply with fair lending and anti-discrimination laws. Predatory lending has no place in our national banking system. Finally, we have an opportunity to expand Project REACh, an OCC-sponsored effort that brings together leaders of banks, civil rights and community groups, tech companies, and businesses to solve problems like credit invisibility, the homeownership gap, and access to capital for minority-owned businesses.

Third, we, as financial regulators, must collectively adapt to the digitalization of banking and finance. I am concerned that the regulatory community is taking a fragmented, agency-by-agency approach to the technology-driven changes taking place today. At the OCC, the focus has been on encouraging responsible innovation. For instance, we updated the framework for chartering national banks and trust companies, and interpreted crypto custody services as part of the business of banking. I have asked staff to review these actions.

With regard to charters, some are concerned that providing charters to fintechs will convey the benefits of banking without its responsibilities. Others are concerned that refusing to charter fintechs will encourage growth of another shadow banking system outside the reach of regulators. I share both of these concerns. Recognizing the OCC's unique authority to grant charters, we must find a way to consider how fintechs and payment platforms fit into the banking system. And we must do it in coordination with the FDIC, the Federal Reserve, and the States.

Finally, we must act on climate change. I believe the OCC can help with this if it adopts a two-pronged approach. First, we must engage with and learn from others. I have asked staff to explore joining the Network for Greening the Financial System, a group of central banks and supervisors from across the globe who share best practices.

Second, we must support the development and adoption of effective climate risk management practices at banks. The OCC's approach today has been focused on monitoring. I have asked staff to develop options for taking more concrete action. We will be proactive in this space and act with a sense of urgency.

Finally, my testimony outlines the review of key regulatory standards in pending matters that I initiated upon becoming Acting Comptroller. Those items include the 2020 CRA final rule, interpretive letters and guidance related to cryptocurrencies and digital assets, and pending licensing decisions. At all stages of the review, I will keep an open mind. I expect the review to conclude this summer. We will evaluate findings and determine our next steps.

Thank you again for this opportunity, and I look forward to your questions.

[The prepared statement of Acting Comptroller Hsu can be found on page 82 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Hsu.

Ms. McWilliams, you are now recognized for 5 minutes.

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

Ms. MCWILLIAMS. Thank you. Chairwoman Waters, Ranking Member McHenry, and members of the committee, thank you for the opportunity to testify today.

While banking-sector income for 2020 declined from 2019, primarily due to higher provision expenses resulting from climate change implementation and economic uncertainty associated with the pandemic, 4th quarter net income rose, reflecting higher non-interest income and lower provision expenses for credit losses, consistent with economic improvement and a more optimistic economic outlook. Despite the challenges of the pandemic, banks increased their capital levels in 2020 and continued to accommodate a sharp increase in deposits, reflecting persistently-high savings rates and lower spending. Banks of all sizes have also continued to support their communities, including by originating the overwhelming majority of approximately $800 billion in Paycheck Protection Program (PPP) loans.

While the rollout of the COVID-19 vaccination program and the reopening of the economy make us cautiously optimistic that things will return to normal, whatever this new normal may look like, we continue to carefully monitor conditions in the banking sector, from commercial real estate, to agricultural and consumer lending, to cybersecurity. While we have focused heavily on ensuring that consumers have access to credit during the pandemic and that banks continue to operate in a safe and sound manner, we have continued several regulatory initiatives along the way as well.

Last December, the FDIC Board approved a final rule updating our broker deposits regulations to address the evolution of how banks offer services and products since the original broker deposits rules were promulgated 30 years ago. We also finalized a rule to codify legally-enforceable commitments of insured industrial banks and industrial loan companies (ILCs) and their parent companies. The rule ensures that the parent company serves as a source of financial strength for the ILC, while providing clarity about the FDIC's supervisory expectations of both of the ILC and its parent company. And this past January, we finalized guidelines establishing a new Office of Supervisory Appeals to help promote consistency among examiners and ensure accountability at the FDIC.

We continue to promote innovation at the Agency and across the banking sector because it is necessary. The pandemic has only amplified how critical innovation is in our everyday activities, from the way we procure food, to our social contact, to how and where we work. Our focus on innovation is aimed at ensuring that American banks remain competitive in a rapidly-changing world, that American consumers have access to a broad array of financial products and services, that our supervisory and risk-monitoring functions can appropriately align with technological changes in the industry, and that we can bring unbanked Americans into the financial fabric of this country and do so in a way that will promote a path to economic and social inclusion.

My focus on economic inclusion is informed, in no small part, by my personal experience as a struggling immigrant in this country. This July will mark my 30th anniversary in the United States. I can assure you that not a day has gone by without me thinking of those early years, when putting food on my table and having a roof over my head required working three to four minimum wage jobs. It is from this perspective that the uneven impact of the pandemic and its recovery on different populations throughout the United States has been especially worrisome.

Notwithstanding meaningful improvements in recent years in reaching the last mile of unbanked households in this country, we know that much remains to be done. To help address these disparities, the FDIC is using its authorities to support a safer, fairer, and more inclusive banking system. We have recently launched a targeted public awareness campaign, #GetBanked, to inform consumers about the benefits of developing a banking relationship. In addition, we announced the establishment of the Mission-Driven Bank Fund to channel private sector investments to support MDIs and CDFIs. We have also recently released a new diversity strategic plan with actionable steps that will guide our work and help measure our progress over the next few years, and support economic inclusion in our communities.

As the FDIC makes progress on these issues, 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 your questions. And happy birthday, Todd.

[The prepared statement of Chair McWilliams can be found on page 96 of the appendix.]

Chairwoman WATERS. Thank you, Ms. McWilliams.

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

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

Mr. QUARLES. Last May, my colleagues and I came before you to discuss our actions to maintain a strong banking sector as a source of support for consumers, households, and businesses. My remarks at that time came after the onset of sudden and pervasive financial stress. Early turmoil in overseas markets quickly crossed borders, and within days, had reached almost every asset class and corner of the financial system. A year ago, the full implications of COVID still remained unclear, and the costs would continue to mount.

Today, the storm waters are receding. The economy is beginning a strong recovery to the other side of the COVID event. And as the Federal Reserve's recent reports detail, banking organizations have remained an important source of strength in this recovery, with higher levels of capital and liquidity, better risk management, and more robust systems.

But banking organizations absorbed an unprecedented shock, while providing refuge from market instability, delivering essential public aid, and working constructively to support borrowers and communities. In short, the full set of post-2008 reforms, as refined and recalibrated by the work of the last 4 years, ensured that this time truly would be different than the last. Today, the U.S. banking system is actually more liquid and better-capitalized than it was a year ago, and, on top of that, has over $100 billion in additional loan loss reserves, leaving it well-positioned to weather future shocks.

While a strong recovery is underway, it is not yet complete. Our role as policymakers is to support the financial system and the economy through the end of this transition back to normal operations. Our challenge is to do so as circumstances change and the nation's need for that support evolves. Most immediately, we have worked to align our emergency actions with other relief efforts as the economic situation improves, maintaining or extending some measures, where appropriate, to preserve household assistance, to promote continued access to credit, and starting the transition back to our normal activities, normal supervisory posture, and our normal rule book.

However, our role and responsibility extends much further than merely returning to normal. We have an obligation to look closely at the last year to understand how the financial system came to experience such severe stress, and to identify and act on any lessons we find. Any list of lessons must begin with the strong performance of supervisory stress testing. The Stress Testing Program not only prepared banks for a period of prolonged hardship, it also clarified their health and resilience as the COVID event progressed. This role affirmed the ways that stress testing has evolved in recent years into a more flexible, more transparent anchor for the Federal Reserve's broader capital program.

For example, while it was sensible, given that this was the first real-world test of the post-2008 system, for us to impose temporary capital distribution restrictions beyond those that are built into this system, we now know that the system works, especially when supplemented and informed by a real-time stress testing machine. In the future, having learned the lessons of this real-world test, we will be able to rely on the automatic restrictions of our carefully-developed framework rather than impose ad hoc and roughly-improvised limitations.

Other areas, however, are ripe for closer examination. These include strains in short-term funding markets and the second destabilizing run on prime money market mutual funds in roughly a decade, Treasury markets where last year's selling pressures overwhelmed dealers' willingness or ability to intermediate, and changing patterns in the use of financial services by consumers and businesses. These trends pre-date the COVID event, but the past year accelerated them dramatically, with important implications for financial stability, safety, soundness, consumer protection, and underserved communities' access to safe and fair financial services.

In our work to understand each of these trends, we have valuable and willing partners in our fellow regulators in other agencies and in our colleagues abroad, and we are committed to keeping Congress closely and actively informed of our efforts. This work is critical, but only in service of a more fundamental goal: A safe, transparent, and efficient approach to supervision and regulation, which ensures that the financial system can withstand even historic shocks. Those values are of perennial importance. They continue to be the bedrock of the Federal Reserve's work, animating two of our highest priorities for this year: finalizing the post-crisis Basel III reforms; and completing the long-overdue transition away from the London Interbank Offered Rate (LIBOR).

The COVID event is not behind us, and the vulnerabilities it exposed are not gone. But as we now follow the path out from this event, the Fed is working to ensure that the financial system is resilient enough to support consumers, households, and businesses, and we recommit ourselves to supporting the economy through the completion of the recovery. Thank you, and I look forward to your questions.

[The prepared statement of Vice Chairman Quarles can be found on page 113 of the appendix.]

Chairwoman WATERS. Thank you, Mr. Quarles. I now recognize myself for 5 minutes for questions.

Chair Harper, I appreciate that early in your tenure at the NCUA, you stressed the importance of consumer financial protection. You recently gave a speech cautioning credit unions to consider the reputational risk they face when they garnish portions of stimulus checks being deposited in a customer's account. Specifically, you said, "As we saw with stimulus payments last year, some credit unions decided to garnish those funds instead of stepping up and working with their members. Credit unions that do this again, should consider the reputational issues that will come from these practices." Have credit unions been responsive to your message to help their customers who have been hurt through no fault of their own during this pandemic?

Mr. HARPER. Thank you, Madam Chairwoman, and what I would say is that in this latest round of the economic stimulus package, credit unions have been indeed stepping up. I am aware that both major trade groups within the industry have called on Congress to: one, work to close the problems related to garnishment; and two, ensure that individual credit unions are working to make sure that people can use these funds in order to pay for shelter, food, and medical needs, which is what Congress intended.

Chairwoman WATERS. Thank you very much. I think I heard you say that you were concerned about post-pandemic foreclosures and the possibility that the credit unions are going to be faced with the situation of homeowners not being able to pay their mortgages. But what I did not hear was you talk about loan modifications and how you are going to deal with that.

Mr. HARPER. That is a really important question, Madam Chairwoman. The latest data that we have internally at the Agency is that there have been 1.3 million forbearance efforts that have gone on since the start of the pandemic, and that we have actually worked to modify about $38 billion in loans. Going forward, we are going to continue to stress to our examiners and credit unions the need to work with members, and that prudent workouts can be a win-win both for the consumer as well as for the credit union, who might have to charge off on foreclosure costs.

Chairwoman WATERS. Thank you very much.

Chairman McWilliams, banks have garnished wages also. Is that correct?

Ms. MCWILLIAMS. I am sure there is a bank that has garnished wages. I don't know that we have broad data points on that. But we have encouraged banks to work with their customers, and we have also identified some activities, such as waiving fees through process, as eligible for consideration under the Community Reinvestment Act. As a general matter, we do not base recommendations on reputational risk, so we have not, to your point in the question to Mr. Harper, issued any guidance on that. But we did issue a number of guidance documents telling banks that they should work with their borrowers, and also making sure that we, and our examiners, do not criticize the banks for working with borrowers affected by COVID in a safe and sound manner.

Institutions generally have not needed to categorize COVID-related loans and modifications, such as Delinquency and Default Reasons (DDRs). We have done a number of things to make sure that borrowers can stay in their homes, and that the issue of forbearance and loan modifications is not something that would, I guess, force consumers out of their homes.

Chairwoman WATERS. Thank you.

Chair Harper, I am concerned about reports that banks are closing branches at a record pace, and now, in some areas, the nearest bank branch might be over 10 miles away. While many customers bank online, the FDIC found that 83 percent of customers still met with a teller or bank employee at least once during 2019, and more than 40 percent of rural customers made at least 10 visits to a bank. What are these customers supposed to do when the bank leaves town?

Mr. HARPER. Thank you, and I share your concern about financial deserts, and the need to step in and make sure that those communities have access to financial services. When a financial institution leaves a town, it can be really debilitating. And what I am aware of is many credit unions have been stepping up through adding underserved areas, particularly one charter type, multiple common bond, to provide services in those areas where they might have been left behind. And I think that is something that we should be continuing to work on with you, and we are doing that through our Advancing Communities through Credit, Education, Stability and Support (ACCESS) initiative currently.

Chairwoman WATERS. Quickly, for example, should we allow a credit union to expand its field of membership to set up a branch in areas where there are no physical branches?

Mr. HARPER. That is something that would certainly be helpful. The NCUA board and its members have long called upon Congress to allow not just multiple common bond credit unions to add underserved areas, but also single common bond, and community charters. That would be a good way potentially to help provide service to those areas.

Chairwoman WATERS. Thank you very much. The gentlewoman from Missouri, Mrs. Wagner, is now recognized for 5 minutes.

Mrs. WAGNER. Thank you, Madam Chairwoman, and I thank our prudential regulators. I only wish that we were all in person in the committee room. It would make this much easier since we are actually all on the Hill just above or next to the hearing room in our offices. I have a number of questions, so I would ask you to please keep your questions brief.

Vice Chair Quarles, as we start to move out of this pandemic, my constituents are seeing an increase in the cost of groceries, gas, and many, many other household items. Manufacturers and other industries are dealing with supply shortages, workforce shortages, and unprecedented costs for raw materials. What economic signals give you reason to believe that these price spikes are only temporary?

Mr. QUARLES. The emergence from any sort of a natural disaster or a suddenly-imposed constraint on economic activity is historically, generally, accompanied by temporary increases in prices, sometimes quite significant, in the emergence from those types of events. This is a very large one, and so we would expect those types of temporary dislocations to be substantial. You have asked me to be brief, so I can leave it at that and see if you want to follow up.

Mrs. WAGNER. Yes. I said the supply chain and raw material costs being so backed up and demand so high, we are questioning the temporary nature of this, and I would like the Fed to consider that.

Acting Comptroller Hsu, could you briefly explain your views on climate change and bank supervision?

[No response.]

Mrs. WAGNER. Okay. This isn't going to work, so Comptroller Hsu, hang on.

Vice Chair Quarles, back to you. What data is necessary to understand climate risks for supervisory purposes?

Mr. QUARLES. There is a range of data, and I can't give you a comprehensive answer to that question because we are in the process of sort of very analytically and comprehensively looking at that question inside the Federal Reserve right now.

Mrs. WAGNER. Really?

Mr. QUARLES. Yes, we think that the question of risk should be an analytical one. It should not be solved by a priori concerns. We should look very closely at what the data actually show. We are in the early stages of developing a framework in order to determine what is the right data, how should—

Mrs. WAGNER. If I could interrupt, Vice Chair Quarles. How will an increased focus on climate change impact the Fed's ability to fulfill its dual mandate of price stability and maximum employment?

Mr. QUARLES. I wouldn't say there has been an increased focus on climate change. There has been an increased focus from the outside of the Fed on how we are looking at climate change as one of the many risks, potential risks to the financial system that we evaluate. But we have—

Mrs. WAGNER. I'm glad to hear that. Thank you. I will leave it at that.

Chairman McWilliams, in your testimony, you mentioned that the FDIC will continue to monitor the impact of climate and other emerging risks on the financial sector. I am wondering what sort of risk management structure the FDIC has in place to support a financial institution's risk management practices? In other words, does the FDIC have the proper tools to assess risk on climate events, such as hurricanes, tornadoes, droughts, and floods, to the financial performance of the banks you examine and supervise?

Ms. MCWILLIAMS. Congresswoman Wagner, that is a great question. FDIC supervisors have long expected financial institutions to consider and appropriately address potential climate risks that could arise in their operating environment as a meaningful safety and soundness—

Mrs. WAGNER. If I could interrupt, what is the risk management structure that you have to support these management practices?

Ms. MCWILLIAMS. We look at whether or not the institutions and their borrowers have appropriate insurance coverage. Are they addressing borrowers' cash flow estimates based on reduced agricultural yields or adverse business conditions? Are they complying with applicable rules, regulations, and building codes, especially in areas, for example, where peril of wind may be a concern? Are economists and financial analysts conducting internal analysis of factors that affect economic banking conditions, including the potential implications of changing environmental conditions? So, we look at all of that. We also have FDIC regional risk committees that include the environmental impact—

Mrs. WAGNER. I think my time has expired.

Comptroller Hsu, I will try and submit my questions to you in writing. Hopefully, you can work out your technical difficulties. This is why we should be in the committee room. I yield back.

Chairwoman WATERS. Thank you very much. Mr. Lynch, you now have the gavel.

Mr. LYNCH. [presiding]. Thank you, Madam Chairwoman. The Chair now recognizes the gentlewoman from New York, Ms. Velazquez, for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman. The reason why we don't have in-person hearings is right here, the list of Republicans who have not been vaccinated, 97 out of 211. I have a responsibility, and we all have a responsibility to protect ourselves and to protect our staff.

Vice Chair Quarles, the Fed's most recent Financial Stability Report, published earlier this month, found that vulnerabilities arising from business debt has fallen since the middle of last year. How have government support programs, like the PPP, the Fed's Paycheck Protection Program, Liquidity Facility, and those in the American Rescue Plan, helped to reduce this vulnerability, stabilize businesses, and improve the overall economy?

Mr. QUARLES. I think it is clear that the various programs that have been put in place, given the size of the shock that was experienced last March, we would have experienced a much deeper and more durable economic contraction, and would have had more lasting economic scarring with closed businesses and defaulting obligations had those programs not been put in place. I think that's inarguable.

Ms. VELAZQUEZ. Thank you. Unfortunately, Mr. Quarles, the report also points out that many small businesses and households remain financially drained, and job losses over the past year have been heavily concentrated among our most financially vulnerable, including many lower-wage workers and racial and ethnic minorities. What threats does a K-shaped or uneven recovery pose to financial stability?

Mr. QUARLES. I would say to that precise question, what threat does it pose to financial stability? Obviously, if there is a significant portion of the populace who experience economic stress even as the overall economy is doing well, that can feed into losses on a cohort of exposures in the financial system that could have consequences. I would say right now, that question is probably less of a financial stability question, however, given the nature and size that we see of that possible effect, and more a question of fairness and policy as to what should be done about those exposures.

Ms. VELAZQUEZ. Do you agree that we need to address systemic inequities in many aspects of our economy, don't you?

Mr. QUARLES. Yes, I think that we do need to ensure that opportunities are equal and that access to financial services is fair and equal across the country. That is a high priority for the Federal Reserve in our supervision of financial systems.

Ms. VELAZQUEZ. Thank you. Acting Comptroller Hsu, yesterday, the OCC announced that it will reconsider last year's rule implementing the Community Reinvestment Act, and that lenders should also start preparing for the regulation to take effect. Can you explain this decision, and do you plan to pursue a joint rulemaking with the Fed and the FDIC?

Mr. HSU. Sure. Can you hear me? I just want to make sure the audio is okay.

Ms. VELAZQUEZ. Yes, I can hear you.

Mr. HSU. Okay. Great. Upon taking office, we had identified several standards and pending matters that I thought would be ripe for some review. And with regards to the CRA specifically, due to the effects of the pandemic on populations, and due to the comments on the Federal Reserve's Advance Notice of Proposed Rulemaking (ANPR) on CRA, and due to some of our experience with partial implementation of the 2020 rule, we had enough information to say that this seems like the right time to reconsider where we are. I initiated a review, but the review has not been completed yet, so I don't want to get in front of the conclusions of that. I am saying that I want to take all of the facts and all of the perspectives into account before deciding what to do. That could include rescission. That could include joining the Fed and the FDIC, the overwhelming comments that we got. So, we are open to those things.

Ms. VELAZQUEZ. I would appreciate if you would consider it. I yield back.

Mr. LYNCH. The gentlelady yields back. The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas, for 5 minutes.

[No response.]

Mr. LYNCH. Mr. Lucas?

[No response.]

Mr. LYNCH. Okay. Mr. Lucas or Mr. Posey, do you want to speak or no?

Mr. POSEY. I will step up here.

Mr. LYNCH. Okay. Great. Thank you.

Mr. POSEY. Thank you, Mr. Chairman. Mr. Quarles, just last week, the April inflation rate was reported at 4.2 percent, the highest since 2009. The rate in March was 2.6 percent. Are we paying the price of monetizing a huge debt with what the late Dr. Friedman and former Chair Bernanke both call, "helicopter money?"

Mr. QUARLES. I don't think so. If you look at the example you gave, that the inflation rate last month was the highest since 2009, I think that is an example of when you come out of a shock, you can see volatility in the inflation rate. And that volatility we would generally expect to be temporary and transitory, given that the size of the shock that we are coming out of from the COVID event is even larger, materially larger, than from the financial crisis of 2008. With those sorts of dislocations, it would not be surprising if they were both sizable and lasted for some period of time. I believe that is the correct analysis of the situation.

If we are wrong, do we have the tools to address it as we see that the world is evolving differently than we expect, and that is absolutely the case. The Federal Reserve has the tools to address inflationary concerns should they prove to be more durable and higher than we currently analyze them to be.

Mr. POSEY. Thank you. Given the Fed's commitment to independence, please describe the condition or scenarios under which the Fed stops monetizing the debt. How would you make that decision?

Mr. QUARLES. Obviously, I should begin by saying I don't think we are monetizing the debt currently because of dislocations that occurred in the Treasury market over the course of 2020. We are purchasing Treasury debt. We have said that we will be examining, over the course of this year, the conditions of the financial markets and when it will be appropriate for us to end those asset purchases. The Federal Open Market Committee (FOMC) discusses that regularly, and that will be the mechanism through which we would make that decision.

Mr. POSEY. Mr. Hsu, the Senate recently made the True Lender Rule subject to a Congressional Review Act resolution. How does allowing States to regulate interstate loans promote interstate commerce, payer choice, and economic welfare?

Mr. HSU. I'm sorry, Congressman Posey. You broke up a little bit at the end. Can you repeat the question?

Mr. POSEY. I'm sorry. I am having a hard time hearing you. What was that again now?

Mr. HSU. You broke up at the end there. Could you repeat the question quickly?

Mr. POSEY. Sure. The Senate recently made the True Lender Rule subject to a Congressional Review Act resolution. How does allowing States to regulate interstate loans remote interstate commerce, greater choice, and economic welfare?

Mr. HSU. Okay. When I took office, I included the True Lender Rule as part of the review that we are going to do. And when the Senate voted to repeal it under the Congressional Review Act, we paused that review because of the congressional deliberation, and we are monitoring how the House's deliberation is going. I don't want to say too much more than that, given the posture.

Mr. POSEY. Right.

Mr. Harper, could you share your experience with us? Will a higher corporate tax rate attract or discourage investment in crop growth?

Mr. HARPER. Thank you for the question, Congressman. Credit unions are not subject to taxation, as they are structured as nonprofit cooperatives that are member-owned, so there would not be a change for credit unions.

Mr. POSEY. Ms. McWilliams, should the prudential regulators require financial institutions to increase their capital to protect against the risk of climate change?

Ms. MCWILLIAMS. I'm sorry, Congressman. I missed the first part of your question. I apologize.

Mr. POSEY. I am running out of time. Should prudential regulators require financial institutions to increase their capital to protect against the risk of climate change?

Ms. MCWILLIAMS. Generally, we approach the capital regulations by basing it on quantitative measures to understand what is going on, and I think it is premature to make any conclusions in this space.

Mr. POSEY. Thank you. Mr. Chairman, I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from California, Mr. Sherman.

[No response.]

Mrs. WAGNER. I rest my case.

Mr. LYNCH. Yes, yes. Let us go back. Mrs. Maloney, would you like 5 minutes for questioning? I see you—

Mrs. MALONEY. Yes, please. Thank you.

Mr. LYNCH. Okay. You are now recognized.

Mrs. MALONEY. I thank you, Mr. Chairman, and Chairwoman Waters and Ranking Member McHenry.

Acting Comptroller Hsu, I was planning to ask about the Community Reinvestment Act (CRA), our nation's law that requires financial institutions to invest in and meet the credit needs of all communities, particularly low- and moderate-income communities, but it is good news. Yesterday, the OCC announced it would reconsider the 2020 final rule, a rule that I believe would significantly weaken the CRA and leave our most-vulnerable communities behind.

I just want to thank you, to begin with. I think that this is a very positive development.

But Acting Comptroller Hsu, as a follow-up to yesterday's announcement and to Congresswoman Velazquez's question, do you believe that our communities would be best served by having one uniform standard across the banking regulators rather than different standards for each regulator and their related financial institutions?

Mr. HSU. As a general matter, yes. I think that is definitely the case. I think there are a lot of devils in the details here, and I am awaiting the review to get that confirmed. I just want to make sure that I think when the agencies act together, the effects are stronger and more sustained. And I think that has been proven many times. So, as a general matter, yes.

Mrs. MALONEY. Okay. And I would like to ask you, what deficiencies in the final rule led the OCC to make its decision to reconsider the 2020 rulemaking?

Mr. HSU. I think it really comes back to those three factors I cited before, which is that the impacts of the pandemic have become much more clear, and so the need is sharpened, and you have more data to support that. The comments on the Fed's ANPR—I think there are a lot of comments there that we have been following very closely. So, there is new information there.

And again, part of our experience with the partial implementation of the rule, which has had its ups and downs, I don't know all of the details around that. But the combination of those factors really prompted me and the staff to say to say, okay, we need to reconsider this.

Mrs. MALONEY. Okay. Changing topics, I want to talk to you about climate change and gun violence, and particularly the OCC's so-called, "fair access rulemaking." In the closing days of the Trump Administration, Acting Comptroller Brooks rushed through a rule to effectively require financial institutions to lend to and support manufacturers responsible for producing the firearms that have devastated our communities. The rule would also have the effect of requiring financial institutions to support the fossil fuel industry with access to banking services, even if those institutions have voluntarily chosen to stop supporting the financing of carbon pollution.

On January 19th, I wrote to then-President-Elect Biden, urging him to block this rulemaking and the harm it would cause to our communities. I was pleased to see that this rulemaking was paused the following week. Do you intend to rescind the OCC's fair access rule?

Mr. HSU. I have no intent to revisit that rule. It has been paused. It is not live. I have no intent to revisit it.

Mrs. MALONEY. I would say the former Acting Comptroller used his authority to rush this through, and now it is paused. But I hope you will use yours to rescind this rulemaking that will devastate communities.

My time has expired, and I yield back. And I look forward to further questions and comments on this and more clarifications on it. I think it should totally be overturned.

Anyway, I yield back. Thank you.

Mr. LYNCH. The gentlelady yields back. The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Mr. Quarles, a minute ago, you said that there was about $100 billion of additional loan loss reserves in the system today, which is good news. Then you made the comment that the vulnerabilities to our system are not gone. So, I would like for you to expand on what you think those vulnerabilities are, number one.

And then, in order to somehow corral those vulnerabilities or to quantify those vulnerabilities, how effective do we need to be with regards to forbearance? It would seem that with the additional reserves that we have, you could take two different approaches.

One is where you would say, well, we have enough reserves here, so let's ride this out, let's work with the banks and our customers because even if things go south, there are plenty of reserves there. It is not going to impact the quality of the banks. Or you could go back to a more punitive approach and say, we have plenty of reserves there. Therefore, let's go in, clean these things up, and take all of this and apply it to the reserves, and then we have a clean slate.

Which approach do you think you want to go with, and what vulnerabilities, I guess, do you believe are still out there?

Mr. QUARLES. With respect to the approach to borrowers who may be under pressure as we emerge from the COVID event, we are continuing our supervisory stance of saying that banks should work with those borrowers. It is your former option rather than the second option of saying since you have the reserves on your books, take the losses and clean up the loans. That is definitely not our approach.

We began the pandemic by saying that banks should work with their borrowers, and that supervisory stance continues to be in place even as forbearance ends. The information we have from our supervision of the banks is that the majority of forbearance hasn't, and customers have resumed paying their loans.

Mr. LUETKEMEYER. I'm sorry to interrupt you, but what vulnerabilities do you see?

Mr. QUARLES. The vulnerabilities, potential vulnerabilities are that, again, certain cohorts of borrowers might have difficulty paying their loans as forbearance ends. We haven't seen that to be an actual fact, as opposed to a potential fact yet. But if it becomes an actual fact, we are encouraging banks to continue to work with those borrowers and not simply close out the loan, where that could be done safely and soundly.

Mr. LUETKEMEYER. Very good. Thank you for that.

Chairwoman McWilliams, the FDIC is tasked with reviewing and approving applications for industrial loan companies (ILCs). In February of this year, the FDIC issued a final rule that codified the ILC process and requires nonfinancial companies applying for an ILC to meet certain conditions prescribed by the FDIC and enter written agreements with the FDIC.

I think many members on this committee have concerns with the commingling of banking and commerce that ILCs represent. Do you think the rule as written today will prevent the commingling of banking and commerce in the future?

Ms. MCWILLIAMS. I think that our final rule certainly goes a long way to impose source of strength requirements on the parent company, which has been a longstanding concern, and this is consistent with the statutory requirement in Section 616 of Dodd-Frank. We are confident that we can adequately supervise ILCs. We have imposed heightened expectations as warranted. We have higher capital levels in traditional banks on these ILCs. We have capital liquidity maintenance agreements. And we have agreements that require the parent company to support the ILC at a time of distress.

Now, I would say that the same statutory requirements for all deposit insurance applicants apply, as Congress gave them to us. I would say we have finalized a rule to require more of ILCs once they get approved and prior to final approval from the parent company, and we require supervision of the parent company. But in the end, we are only working with the rules that Congress gave us, and those rules are the same whether applying for a de novo banking charter, insurance—deposit insurance, or for the ILC charter deposit insurance.

Mr. LUETKEMEYER. Your expectation is then to be able to have some oversight over the parent company as well?

Ms. MCWILLIAMS. That is what we codified in our rulemaking. Again, wanting to make sure that the parent company is liable to support the ILC and serves as the source of strength, both as required by Section 616 of Dodd-Frank as well as by our internal understanding of how ILCs function, et cetera, et cetera.

I would say that we are comfortable with where we are. Again, it is up to Congress to decide if that is sufficient or not. But as a regulator, I am comfortable where we are.

Mr. LUETKEMEYER. Thank you for that.

Just a quick question with regards to the proposed tax plan by the Administration. This plan is going to have devastating effects on small businesses with regards to doubling capital gains, and raising the tax rate. A million companies are structured C Corps. You are looking at the estate tax, the second estate tax—

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

Mr. LUETKEMEYER. We will submit that for the record then. I am just curious as to your concerns about the tax plan with regard to small businesses. So, thank you for that.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you.

We have gone through 2 great domestic crises in the last 2 decades. In 2008, the crisis was caused by the financial system. This most recent crisis, the financial system didn't cause it. It was caused by a virus. And the financial system has shown remarkable resiliency in part because of the regulatory authorities and rules that we are dealing with here today and in part because of the tremendous response by Congress. So, we got something right. The financial rules that we had in place in 2008, I don't think would have survived the virus of 2019.

And Mr. Quarles, I want to thank you for mentioning LIBOR, and I especially want to thank you and the Fed for working with me to craft legislation to deal with that problem hopefully well before the problem affects trillions of dollars of outstanding adjustable rate debt instruments.

As to credit unions, I am pleased that Chairman Harper is with us. I want to thank Chairwoman Waters for including as part of today's hearing the discussion draft of a bill that would expand credit unions' ability to lend to their member businesses in underserved areas, and the chairwoman's mention of the fact that perhaps we ought to have credit unions be able to establish branches in our unfortunately growing financial deserts.

I want to focus a little bit on the industrial loan companies, which is a matter of prudential regulation but is more important than just prudential regulation. We have had a rule in our economy for a long time of separating financial services from commerce and industry. Japan went the other direction, and if you look at their stagnation, particularly in the 1980s and 1990s, Japan was not served well by mixing the two together.

While the courts and then Congress have allowed the mixing of this financial activity with that financial activity, we have not allowed the mixing of banking and commerce. But we have had the ILCs. They played a very modest role in our economy. They are historic. They are doing fine, unless they are used as a way to blow a hole in what has been this wall for 100 years, or nearly 100 years between commerce and banking. And we then could end up with Walmart, Amazon, et cetera.

I believe the FDIC should be looking at a moratorium on new ILC charters to give Congress time to look more closely at the ILC issue. Would you be open to considering either a temporary moratorium on ILCs or a temporary moratorium on any ILC that mixes banking and nonfinancial services?

Ms. MCWILLIAMS. Thank you for that question. And I will say I am open to whatever Congress tells us to do.

Congressman, I want to make sure that you don't misinterpret my tenacity in making sure that the FDIC follows the law that Congress gave us for either my love or hate of the ILCs. I don't have feelings about them. I don't think they are great. I don't think they are bad. I just look at the statutory requirements, and I know what Congress has given us. And should you give us the mandate to put a moratorium in place, we will do so. Should you give us a mandate to do something different with the ILCs, we will absolutely do so.

In the meantime, we have done what we can with our supervisory tools to make sure that there is safety and soundness in the system, that the parent is on the hook for the subsidiary for the insured depository institution. And if you—

Mr. SHERMAN. I doubt very much whether Amazon or Walmart will be as regulated by the FDIC as banks and bank holding companies.

I do want to turn to Mr. Quarles. It is critical that we enforce our anti-money laundering and know-your-customer rules, especially in light of President Biden's efforts to collect the hundreds of billions of dollars of uncollected taxes from the top 1 percent. Chairman Powell has said that the Fed would not proceed with creating a—

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

Mr. SHERMAN. I will make this a question for the record. Thank you.

Mr. LYNCH. I thank the gentleman. The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman.

And I guess I just want to point out with respect to this one thing from my colleague from New York, another fine piece of journalism where a non-answer is actually an answer when they are talking about vaccinations. It's none of their business.

But I digress. I want to move on to the ILCs. I know this has suddenly gotten a lot of discussion. And Ms. McWilliams, I have a quick question for you, I guess. I want to expand on this a little bit. Is there a widespread problem of the rules not being followed by ILCs currently?

Ms. MCWILLIAMS. I'm sorry. Do you mean with respect to our rules, the FDIC-mandated rules?

Mr. HUIZENGA. Yes, I guess so. There are some implications that somehow there are rules that are currently in place that aren't being followed. Or I guess maybe the question is, is there a problem that needs to be solved here by Congress or by you, as the FDIC? I know you have just finalized the rules on that. Is there a real problem with ILCs as we currently are dealing with them?

Ms. MCWILLIAMS. I will tell you from a regulatory and supervisory perspective, we do not see a problem with our authorities to appropriately supervise the ILCs. Again, as I mentioned, we impose the same standards as they get approved as we do for banks, and then once they are approved, we actually impose heightened expectations as warranted based on the risk model and the business profile of the entities themselves.

This can include significantly higher capital levels than traditional banks. We also add them to entering the so-called Capital and Liquidity Maintenance Agreements (CALMA), where the parent has to not only agree to our supervision, but also be willing to put in money, capital to support the insured depository, and we also have the parent company agreements along the same lines.

So, I would say that you have given us adequate tools to appropriately supervise ILCs from that perspective.

Mr. HUIZENGA. Okay. Let us move on to LIBOR. Vice Chair Quarles, I would like to follow up on our various conversations that we have had on LIBOR. I am hearing from a number of financial institutions of various sizes across the country regarding this transfer away from LIBOR. Many have expressed concerns with the Secured Overnight Financing Rate (SOFR) and what that means, this sort of one-size-fits-all benchmark that may be out there.

What are the specific challenges facing the Federal Reserve regarding LIBOR to SOFR transfer, and does the Fed still believe that SOFR is actually the best fallback rate?

Mr. QUARLES. The fundamental position of the Fed with respect to the LIBOR transition is that LIBOR is ending. It will not be able to be used. We believe it is a safety and soundness concern for it to be used for new contracts after the end of this year. We will supervise firms so that their new contracts cannot be written on it.

Firms have to be prepared for that transition. There will be a significant amount of legacy contracts that will need transition. Federal legislation is likely to be appropriate in that context to help with the legacy.

As for SOFR—

Mr. HUIZENGA. With all due respect, we know all that. I need to know—my time is very short here.

Mr. QUARLES. As for SOFR, SOFR is a robust rate developed by a comprehensive—

Mr. HUIZENGA. Is it the best way? Because I am hearing from some others that they think that there may be some different directions that this should go.

Mr. QUARLES. The position of the Federal Reserve is that banks need to prepare for the transition, not that they must transition to a particular rate.

Mr. HUIZENGA. Okay. Acting Comptroller Hsu, what is going on at the OCC? The Administration can't seem to get it quite right on the appointments. But the OCC finalized a rule, the True Lender Rule, and then a few weeks ago, your predecessor came out and supported that rule. And then, shortly after your appointment, the Senate and the White House opposed the rule.

Is the changing position suggesting that this is a political decision, or is this decision based on data and what is right for consumers?

Mr. HSU. With regard to True Lender, we were going to review it. But once the Senate voted to repeal it under CRA, we basically stepped back, because now it is under congressional deliberation. So, we are just monitoring Congress' deliberations on the matter.

Mr. HUIZENGA. Okay. We will follow up on some questions as well. Thank you.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much. The first thing I want to say is, happy birthday to Chairman Todd Harper. Happy birthday, my friend.

Mr. Chairman, yesterday, the House of Representatives passed my bill on financial inclusion, thanks to a helping hand from Reverend Cleaver, and my good friend, French Hill of Arkansas. And I am deeply concerned about our consumers, as you are, unbanked and underbanked who are just out here subject to the whims and the ravages of payday lenders. And I was interested to learn of NCUA's payday alternative loan program that you have, which allows Federal credit unions to offer lending products that are safer and more affordable than payday lenders. I want you to give me an update on these lending products.

Mr. HARPER. Certainly, Congressman. The payday alternative loan rule, or PALS for short, has been part of the NCUA's rules for more than a decade now. And what we have found is that many credit unions are using it quite prudently. They can lend up to 28 percent, which is slightly higher than the 18 percent cap imposed for all loans, and they also need to work these loans into an amortized basis.

Our payday alternative loan program is working well, and it is something that we have certainly seen a number of credit unions use during this crisis. I will also just note very quickly that many credit unions are offering small dollar loans well under the 18 percent cap outside of the payday lending program, so they are stepping up to serve their members.

Mr. SCOTT. Let me ask you this, because I have sort of an Achilles Heel in this moment, and my concern comes back to the unbanked and underbanked. And although this product that you have is available to credit union members, how do consumers who are not members of a credit union have access to a product like this? How do we get it down to those who need it the most?

Mr. HARPER. I appreciate the question and the desire to expand access to financial services. I know that former Chairman Hood, now Board Member Hood at the Agency, has spoken often about financial inclusion.

One of the ways and things we could do is to step up—and we have Agency staff working on this right now—to improve our database to help consumers find a particular loan or an institution, a credit union which they could join. That is certainly one way in which we can attack this problem.

Mr. SCOTT. And certainly, our bill passing the House yesterday brings in the consumer financial protection services. And I would like for you to help us to get the word out on that, getting our bill passed, because while yours is targeted to folks who need the help, it is exclusive only to credit union members, correct?

Mr. HARPER. That is correct, if I understand the question, yes.

Mr. SCOTT. Okay. Now, Ms. McWilliams, let me ask you this, I think I may have a moment. How are your regulated banks preparing to handle loans emerging from forbearance? We have passed the American Rescue Plan, and we have a piece in there that would allow loan forbearance for those impacted from the pandemic hardships. What steps are you taking to ensure that these loans remain sound?

Ms. MCWILLIAMS. Thank you for that question. We have done a number of things at the FDIC to make sure that banks actually appropriately modify loans, and we also went to great lengths to make sure that loans modified for the purposes of the pandemic that were performing before the pandemic that were modified in a safe and sound manner actually do not qualify as troubled debt restructuring.

Mr. SCOTT. Thank you, ma'am.

Mr. LYNCH. The gentleman's time has expired. The Chair now recognizes the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

And I want to thank Chairwoman Waters—I don't know if she is still here—but I want to thank her for raising a question about the decline in physical bank branches in rural and underserved areas. That may be why the Majority attached to this hearing a bill requiring a study on de novo bank formation.

I think we can all agree that reversing the trend in lackluster de novo formation is a worthy policy goal and could address the decline in rural bank branches, as Chair McWilliams knows very, very well. But we can do better than a study.

My bill, the Promoting Access to Capital in Underbanked Communities Act, is a straightforward solution endorsed by the Independent Community Bankers of America (ICBA), allowing for a phase-in of capital requirements for de novo institutions, including some provisions targeted toward underserved rural areas and several other common-sense provisions to promote bank access in unbanked communities.

Rather than simply study the issue, let's do something about it. I will put my request to Chairwoman Waters formally in a letter, but I would encourage the Majority, everyone on this Zoom call in the Congress, to consider my bill at the next markup. There is no reason why this shouldn't be a bipartisan effort.

Now, my first question is to Vice Chair Quarles. As you and I have discussed, vocal advocates on the left and some members of this committee continue to push the Fed to inject climate scenarios into stress tests and capital requirements. Earlier this month, the Center for American Progress suggested that regulators could address climate change by risk-weighting carbon-intensive assets and capital requirements.

Proponents suggest that regulators should use bank capital requirements to make the financial system more resilient and force the transition away from fossil energy. The problem is that will do nothing to change the demand side of the equation. People will still need to drive cars, turn on their lights, and heat their homes. It will just disrupt the supply side by shifting financing for those industries to less regulated, nonbank lenders, drive up the cost of capital, and in turn, raise prices for consumers.

Vice Chair Quarles, is the Fed's role to devise and implement climate change policy, and more specifically, is it the Fed's job to accelerate the transition away from fossil energy?

Mr. QUARLES. Our role is to ensure that the financial system is resilient to risks. Those logically could include climate risks, and so we need to analyze how that could happen. But it is not our job to use the financial system as a tool of broader climate policy. That is, we don't have that mandate.

Mr. BARR. It is encouraging to hear that confirmation on the record, and I would encourage you to share that with Mr. Stiroh and the Supervision Climate Committee. And I would encourage you to continue to vocally express that viewpoint to Governor Brainard and others at the Fed, that you do not have the legal authority to implement environmental policy.

Let me turn to Acting Comptroller Hsu. I continue to be troubled by the trend of politicization of access to capital, whereby perfectly legal businesses are denied financing because they are industries that are politically unfashionable. That is why I was pleased to see the OCC finalize the fair access rule in January.

Acting Comptroller Hsu, given that the OCC announced that it will not enforce the fair access rule, how do you intend to prevent national banks from discrimination and redlining? How do you intend to ensure that regulated entities extend financing on a fair and equitable basis without regard to political or public relations pressure?

And in the context of your prepared testimony, sir, your emphasis on reducing inequality in banking sounds like hollow rhetoric and an empty gesture, considering your decision to not enforce fair access. Can you comment on that and the inconsistency of that testimony with your decision and the OCC's decision to not move forward and implement fair access?

Mr. HSU. Sure. I will start with reducing inequality. The components of reducing inequality really focus, first and foremost, on the Community Reinvestment Act. So, I am not going to take up time with that.

Mr. BARR. Yes, I hear you. But you know what I am talking about. It is a philosophically-inconsistent position to say that you are for equality in banking when you will not enforce a fair access rule and you will not prevent discrimination against whole categories of customers because of the politically-incorrect status. It is intellectually inconsistent.

Mr. HSU. I guess I would disagree with that.

Mr. BARR. I can tell.

Mr. HSU. We are not in the business of telling banks whom to bank. We are in the business of safety and soundness, of treating customers fairly, and of ensuring that there is access to financial services, especially to those who are underbanked and unbanked. That is our mission.

Mr. BARR. Right. My time has expired. But if redlining is wrong, redlining is wrong. End of story.

I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Let me address my first question to Chair McWilliams. There are approximately 250 FDIC-insured MDIs and CDFIs that serve minority, low- and moderate-income communities. These institutions are pillars for the communities that they serve because unlike traditional larger banks, CDFIs or MDIs provide a significantly larger percentage of lending and services to these communities. While MDIs and CDFIs are assisted in receiving deposits, without the necessary capital investment, these entities are unable to fully serve their communities to the best of their ability.

The FDIC's mission-driven fund seeks to help in this area by providing a framework for an investment fund that will support these crucial financial institutions. The fund will allow for investment pitches for banks and help set up fund management.

However, what is puzzling to me is that it is my understanding that the FDIC will be taking a hands-off approach after setting up the framework. If that is the case, how will the FDIC ensure that the fund is actually successful at achieving its mission?

Ms. MCWILLIAMS. Thank you for that question, and I welcome the opportunity to talk about the mission-driven bank fund because that is something that, frankly, is novel to us. It is something that we came up with as a result of extensive outreach with minority depository institutions to understand what particular issues they are facing.

And to your point, because they do disproportionately serve the low- and moderate-income communities, it is important that they have good access to capital. And almost inevitably, most of them define capital, access to capital, as one of the greatest impediments to their ability to serve their communities.

The mission-driven bank fund is going to be set up in a way that we as a Federal Government Agency can set it up, which is basically to put our name, our brand behind it. We have worked extensively with our MDIs as well as with outside consultants to understand how to structure this fund.

I am not sure that we have the requisite authorities necessarily to manage the fund and be the fund manager, per se, as you would think about a fund manager in the financial sense. But we are hoping that the fund manager that gets picked by the anchor investors is focused on kind of the benefits of the investments, and has a long-term strategy of understanding the nature of these institutions and making sure that the capital deployed to the fund is actually producing even more benefits on the ground than dollar for dollar.

That is something that we are going to completely continue to work on and stress about to make sure that people understand this, to make sure that the anchor investors understand that. Our hope, and this is why I appreciate the opportunity to talk about it in a public forum, is to actually attract between $250 million to $500 million in this fund and get it started. We have a $100 million commitment from Microsoft, for which we are very grateful. And we are hoping that is going to be a significant fund with meaningful long-term benefits to the very communities that I believe you are concerned about.

Mr. MEEKS. Yes, and I am hoping the same. I just want to make sure that you don't take a hands-off approach, because we just have to stay hands-on to make sure we accomplish the mission. And we are dependent upon the FDIC to not just not take your hands off, but to stay focused on it, because this is tremendously important and could be groundbreaking.

So, we will be watching, and I hope that you stay actively involved in that regard with the FDIC. Thank you for that.

Ms. MCWILLIAMS. Congressman Meeks, I can assure you that I am not a hands-off regulator.

Mr. MEEKS. Thank you.

And let me go to Mr. Hsu. Mr. Hsu, I am hearing that you have been punting this question recently. But you know that the Senate recently voted to overturn the OCC's True Lender Rule—and I know you are punting on True Lender—which was introduced to clarify the status of loans made through bank-fintech partnerships. However, the Trump Administration's process for promulgating the rule was rushed and lacked adequate stakeholder input, including input from Congressional Democrats like me.

Still, the rule did attempt to address a legitimate public policy problem. If the House votes to overturn the rule and the President signs, will the OCC have the legal authority to put forth a new rule that brings long called-for legal supervisory certainty and enhanced consumer protections to the bank partnerships model?

Mr. HSU. Congressman Meeks, if the True Lender Rule is repealed, I cannot say at this time exactly what we would do and how much litigation would actually come with that. But what I can say is that we are fully committed to the mission of the agency, which is to ensure access to financial services, especially to those who are underbanked and unbanked, and that customers are treated fairly, which includes not having a place for predatory lending in rates charters.

I think we still we need to review that. We need to study that carefully. I can't speak to that, but I can commit to the mission.

Mr. MEEKS. Thank you. My time has expired.

Thank you. I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Texas, Mr. Williams, for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Mr. Chairman.

Chairman McWilliams, it is good to see you again. I want to thank you for all of the work that you and your team at the FDIC have done regarding the brokered deposits rulemaking. As you know, that is something that I have been working on for many Congresses, and it is nice to see the regulatory regime moving in the right direction.

And while you have done your job at the Agency level, I think we should have a legislative solution. I want to give you the opportunity to briefly discuss the brokered deposits rulemaking and the benefits it will have within the banking space, and that I would hope to secure a commitment on if you are willing to work with my office in crafting a more permanent legislation fix, which I think is very important.

Ms. McWILLIAMS. Thank you, Congressman. I really appreciate an opportunity to talk about the broker deposit rule. As you well know, and I know I have spent a lot of time thinking about this issue, the rule, the original rule was about 30 years old. And there has not been a meaningful update to that rule, even though the way consumers bank now and the way that banks interact with their customers and the products they offer have been vastly different than they were in the past when the rule was initially promulgated.

What we did with our framework is we tried to create something that can have a longer-lasting impact to accommodate the flexibility in the technological changes that may not even be anticipated by us at this time. Our rule provides more certainty as to who is a deposit broker. It basically provides a roadmap to how one can be a deposit broker, as well as provides certainty to the marketplace as consumers look to engage with different financial institutions.

I will say that however great our rule is, it is not perfect. And namely, it is not perfect because we can never adequately appreciate and anticipate technological changes that are going to be developing in the world of banking and how consumers and banks interact. And I believe, as I mentioned in my written testimony, that congressional action would be beneficial and preferred, frankly, to the current approach, including putting an asset growth cap on troubled institutions versus putting restrictions on broker deposits and labeling an entire category of assets in a negative light.

I am more than willing to work with you on coming up with a permanent and lasting congressional solution that would allow us to move forward with technological advances and innovation in the banking sector, while making sure that consumers are protected, and banks understand how these things are done, and that gives us an ability as a regulatory agency to appropriately monitor the risk in the system.

Mr. WILLIAMS OF TEXAS. Thank you for that, and we will work together.

Ms. McWILLIAMS. Thank you.

Mr. WILLIAMS OF TEXAS. Acting Comptroller Hsu, a few weeks ago, I asked your predecessor, Brian Brooks, while he was in front of this committee, about the True Lender Rule and if it would be a good deal to repeal it through the Congressional Review Act. He told us he disagreed with not only the justification behind repealing it from a policy standpoint, since the rule specifically prohibits a rent-a-bank scheme, but he also said that it would hamstring the OCC from crafting a substantially similar rule in the future.

Our colleagues on the Senate side did not listen to your predecessor and went ahead and passed the CRA anyway. Comptroller Hsu, how do you plan on proceeding if the rule is overturned and industry participants are left without the clarity that they need to continue serving their customers?

Mr. HSU. I am not exactly sure. I can't say exactly at this time how we would proceed, and I can't—we don't know right now what litigation risks that would attach to how we would proceed. But I can commit that we would pursue our mission, and the mission is to ensure that there is access to financial services for everybody and that everybody is treated fairly.

And that is our compass that we would be utilizing, and we will do that in accordance with the law.

Mr. WILLIAMS OF TEXAS. Okay. Vice Chairman Quarles, the Federal Reserve took some extraordinary actions when the pandemic began, since there was so much uncertainty surrounding the virus. Now that we are finally seeing the light at the end of the tunnel in some places, and life seems to be getting back to normal, I am concerned that some of the temporary measures are going to become common practices at the Federal Reserve.

It is hard to show restraint and not pull out every tool at your disposal when the economy begins to look a little shaky. Vice Chairman, what checks are in place at the Federal Reserve so that they only take these extraordinary measures during true emergencies?

Mr. QUARLES. The governance around the use of these actions is designed to ensure that. There needs to be a majority on the Board to institute—you have to get a majority of the Board for a number of special actions during a crisis.

Mr. WILLIAMS OF TEXAS. Okay. I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the witnesses for appearing. I especially thank Chairwoman Waters for deciding to hold this hearing. It is exceedingly important.

Mr. Quarles, as Vice Chair of the Fed, I am concerned about your desire to work with MIT—the Boston Reserve working with MIT to create a central bank digital currency pilot project. I think that is a great idea. My concern, however, emanates from knowing that if you are successful, we still have the other cryptocurrencies that will be available to those who seem to see this as a means of facilitating a criminal enterprise.

You might recall that with the Colonial Pipeline, there was a request and a requirement that the ransom, as it were, be paid in a certain cryptocurrency. We will still have this problem to deal with, assuming you are successful in creating a central bank digital currency.

I am curious, and would like to know, how do you see us managing these other currencies? Do we go so far as to declare them unconstitutional in some way, ban them in some way, make them counterfeit? What do we do with these other currencies that will still be available to us?

Mr. QUARLES. It is a complicated question because there are a range of types of instruments that count as cryptocurrencies.

Mr. GREEN. If I may, then to help us narrow it, let us just talk about the type that is used by these criminal enterprises to facilitate the transaction of money in an anonymous fashion.

Mr. QUARLES. The use of those payments mechanisms for illegal purposes is illegal and should be prosecuted. We are in the process at the Fed of studying the various ways to try to address this issue, whether a central bank digital currency, although that is very early on, thinking about the proper regulatory framework for these cryptocurrencies, which I do believe, as with any payment mechanism, it is possible to craft regulatory frameworks that—

Mr. GREEN. Give me some sense of how we can regulate them, please?

Mr. QUARLES. I think it would be premature to say that, but to give a concrete regulatory framework, we have developed—

Mr. GREEN. Excuse me. Give me an example that is not concrete. I am trying to get some sense of what we can do. This is a serious issue for those of us who are charged with the responsibility of making hard choices about these issues. So, we need your expertise. Give us some sense, please?

Mr. QUARLES. Financial institutions that engage with these cryptocurrencies will need to comply with all applicable requirements, including anti-money laundering requirements. We supervise them for that currently.

MR. GREEN. How do you know your customers?

Mr. QUARLES. We require the bank to know their customer, and if the instrument itself doesn't allow that, they need to have another mechanism. It is as if the person comes in with cash, the cash itself doesn't identify the customer, but the bank needs to know the customer, and we have rules around that.

There is more work that needs to be done, and we are eager to engage with those who are interested in the question. But I do think the question is thinking through a right regulatory framework, and that central regulatory framework can be creative.

Mr. GREEN. And assuming that we succeed with a central bank digital currency, is that currency going to be one that will be readily available to those who not only want it for legitimate means, but also for some untoward means? Meaning, will we be able to, in your opinion, circumvent the use of it for paying ransom, for want of better terminology?

Mr. QUARLES. Were we to have a central bank digital currency, we would clearly design it to prevent its use for those purposes. However, whether we would have a central bank digital currency is too premature to say at this point.

Mr. GREEN. My time is up, and I thank you for indulging me.

I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Arkansas, Mr. Hill, for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman, and thanks for having our Agency heads come before us today for this discussion. It is very helpful.

Let me start with my friend, the Vice Chairman of the Fed, Mr. Quarles. Our community banks in Arkansas have raised this issue among themselves quite a bit, which is with the 28 percent increase in the money supply over the last year and so much liquidity, both from monetary policy action and fiscal action pouring into the banks, a lot of our community banks are concerned about the impact of this liquidity on their capital ratios.

How are you looking at that, and what kind of regulatory problems does that create?

Mr. QUARLES. We are monitoring the evolution of that phenomenon across the banking system. The principal issue is that the capital ratio constraint that arises when you have this large increase in deposits is from the leverage ratio, which is a non-risk sensitive ratio.

And if the binding capital constraint on an institution is not risk-sensitive, then that will encourage risk taking by the institution at the margins. We want the leverage ratios to be backstops, but not the capital ratio that institutions look at in the first instance.

That is as the amount of reserves in the banking system, as the amount of deposits in the banking system grow, and they will continue to grow over the course of this year and have grown substantially over 2020, that is something that we have to be taking a look at. We are monitoring it closely.

Right now, it doesn't seem to call for a change, but that is something we will be looking at very closely in the coming months.

Mr. HILL. Thank you.

Chairwoman McWilliams, you have testified before Congress before and expressed your concerns about credit unions buying community banks. And obviously, that is something that community banks in Arkansas have raised with me. Recently, a $1.6 billion bank was purchased by an out-of-State, $10 billion credit union.

Do you still have those concerns, and how does the FDIC look at this from an approval point of view, and do you have the tools to adequately assess it?

Ms. MCWILLIAMS. Thank you, Congressman, for that question.

I have heard about the same concerns from banks, which is why I commented to a question that was presented to me in a prior hearing. I would say that we always have a lot of questions when there is an acquisition of a community bank, in particular, and I would say especially if that community bank is located in a rural area or an area where the banking deserts are more likely to exist than not.

During my first year as Chairman of the FDIC, in what I like to call the peace time, when the economy was doing superbly well, we had 220 banks merged into other banks and/or credit unions, which is a large and significant number of the community banks that disappeared from America's landscape. And if that trend continues during my 5 years as Chairman, we would have over 1,000 fewer banks in the United States of America.

Now as you know, consolidation has been a longstanding issue. It has been going on for 30-plus years now. I don't know what the appropriate number of banks is in the United States, but I do have concerns that some communities—farming communities, inner-city communities, rural communities, et cetera—are not necessarily appropriately served by the number of entities in their area, and any consolidation, any merger presents an issue for us from that perspective.

I would say my concerns have not changed. If anything, we have just even been more alerted to consolidation, given the pandemic and its disproportionate impact on those communities.

Mr. HILL. Thank you. Thank you for that.

Let me turn quickly to one final topic. Let me go back to you, Mr. Quarles. I talked to the OCC at a Capital Markets Subcommittee hearing recently, and this was about the transition away from LIBOR. And some community banks are concerned about going to SOFR versus another rate.

My question is, in looking at Mr. Sherman's draft bill, he seems to imply that SOFR is the only legal certainty default in a contract to LIBOR. Does the Fed support a variety of alternatives in that approach to replace LIBOR?

Mr. QUARLES. I think that we don't support every alternative because the rate has to be essentially not readily susceptible to manipulation. But we don't support a single alternative.

Mr. HILL. Thank you. I yield back, Mr. Chairman.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman, and I appreciate this hearing, and it is very timely. Let me try to get into it and get as much as I can in here.

Mr. Harper, I am very pleased and excited about the update that OCC did or issued a new rule so that now banks can get credit for digital inclusion, and that is an update which meets one of our needs. Some of us, like me—I represent Kansas City, Missouri, which is the largest City in the State of Missouri. But then, I also represent Mayview, which has 225 people, and we obviously have some digital needs there. So, I am pleased with that.

What is the flexibility that banks would have to do a CRA-like digital inclusion? I don't know how you came up with that decision or how the OCC came up with that decision, but I thought it was right on time. So, what is the flexibility?

Mr. HSU. Congressman, I am not sure if that question was for NCUA Chair Harper, or for me, at the OCC.

Mr. CLEAVER. Anyone can answer.

Mr. HSU. I guess I can say that financial inclusion is extremely important. This is a top priority. We have a number of initiatives focused on it. I would be happy to kind of talk through the details. I know time is limited.

But we have both through rules, a rule reconsideration and programs. We have lots of things that are in the hopper that we would be happy to talk about with your staff.

Mr. CLEAVER. Okay. The reason I am bringing this up is because I think CRA—I have said this, and I think a lot of my colleagues agree we need a complete update on CRA. And as you may know, our chairperson and probably, hopefully, the overwhelming majority of the members of this committee are in strong support of trying to do something significant as it relates to affordable housing.

And maybe a different way that CRA could be handled is making investments in some of the projects that might be brought forward by HUD or community organizations in concert with HUD. And so, maybe something new, not just making a loan in a difficult neighborhood.

But do you think that there can be some creative ways in which CRA can be involved economically in the production of affordable homes?

Any of you?

Mr. HSU. I will take a stab at it. Affordable housing is a huge problem. We have been focused on it from a couple of angles. One, through Project REACh, where you have to help the borrower, so there is a program dealing with down payment assistance. That can be quite helpful.

The other is to increase the supply of available housing so that it is more affordable because there are supply-demand dynamics in the pandemic which have put things out of whack. These are very complicated underneath, but we would be happy to kind of—and we are open to all ideas on this.

Mr. CLEAVER. Okay. My time is probably about up. I don't think I want to do anything and I don't think anybody else wants to do anything that would not be consistent with safe and sound banking practices. But I think that if CRA is going to continue to be a benefit, it has to change with the issues that are at this time significant. And right now, affordable housing is a problem in just about every community, including rural America, which I represent.

Anyway, thank you very kindly. I yield back, Mr. Chairman.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Minnesota, Mr. Emmer, for 5 minutes.

Mr. EMMER. Thank you. And thank you to all of the witnesses for your attendance.

These oversight hearings are a great opportunity for Members of Congress to touch base with regulators and determine how we can best serve the financial interests of the American people. I look forward to advancing this interest as the ranking member of the Subcommittee on Oversight and Investigation.

Mr. Hsu, I also greatly appreciate the mention you made in your testimony of the work previously done by the OCC to clarify crypto custody services by banks. This type of guidance, which allows businesses to know the rules of the road, is key to enabling the United States OCC Acting Comptroller to continue to thrive as a technology leader.

Now to all of you—Mr. Hsu and all of the other witnesses—countries around the world are looking to blockchain technology to transform industry. Consider China, for example, with its digital yuan. While there is much to work through as our government considers the benefits of this technology and potentially issues a digital dollar on blockchain, I hope that each of your agencies are developing expertise in digital currency policy.

To that end, please describe briefly—if each of you will do this, please describe briefly for me what actions you are taking to increase your Agency's fluency in this emerging policy area. And will you please provide our office with the names and titles of staff in your Agency who are leading these efforts?

I will start with Vice Chair Quarles.

Mr. QUARLES. I think that we have probably, as was recently mentioned—we have the central bank digital currency (CBDC) pilot with MIT, which is being led through our Boston Federal Reserve Bank in conjunction with MIT. There is general policy work around the system, in addition to that pilot project and thinking about central bank digital currency and what the approach to that ought to be, and whether it is something that is appropriate for the United States.

I think those would be the major points right now.

Mr. EMMER. Right. And if you could provide us with some contact folks in your office?

Mr. QUARLES. Oh, absolutely. We would be delighted to be engaged with your office on that.

Mr. EMMER. Excellent. Chairwoman McWilliams?

Ms. MCWILLIAMS. Absolutely. Thank you for that question.

As you may know, the FDIC does not insure deposits denominated in a cryptocurrency, but we recognize that the use of virtual currencies and digital assets has been growing rapidly in recent years among the banks, and that some banks, including some of our banks, are starting to explore a number of different potential uses for their digital assets.

And because this is a null area, because we need to know what is going on in this space, we decided to issue a request for information to solicit feedback regarding what banks are doing, and how they are doing it. What do we as a supervisor need to know, as a deposit insurer need to know, as a resolution authority need to know?

And I have personally tasked a number of individuals at the FDIC with handling this issue for us, including my Chief Operating Officer Brandon Milhorn, Chief Innovation Officer Sultan Meghji, Chief Counsel Nick Podsiadly, and one of our attorneys, Chris Ledoux. And that is just the tip of the iceberg. We can provide other names, and I am sure they will be happy to talk to your people on this important issue.

Mr. EMMER. Excellent. Thank you very much.

Acting Comptroller Hsu?

Mr. HSU. Sure. This is a really, really important issue. I think that the rise of crypto has garnered a lot of attention. Prior to this meeting, Vice Chair Quarles, Chair McWilliams, and I have talked about potentially putting together an interagency policy sprint team just on crypto because of exactly the concerns you describe.

I would be happy to share the names of the OCC leaders on that, and to work with your staff on that.

Mr. EMMER. Great. Chair Harper?

Mr. HARPER. Thank you. And just as the financial services world innovates, we need to adjust to that. We actually, as part of this year's budget, created a new unit focused on financial technology and innovation. One of the charges of that unit is cryptocurrency. We are currently advertising for a director, and we are going to be coming out similar to the FDIC with a request for information on this.

I know that this has been an important issue for Vice Chairman Kyle Hauptman, and the Board is going to be definitely working further on this matter.

Mr. EMMER. Great. Can we get some contact information?

Mr. HARPER. Absolutely.

Mr. EMMER. Thank you, Mr. Chairman. And thanks to the witnesses.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Colorado, Mr. Perlmutter, for 5 minutes.

Mr. PERLMUTTER. Thank you, Mr. Lynch. You are doing a great job as Chair.

Mr. LYNCH. You are very kind.

Mr. PERLMUTTER. First, I would like to thank our panelists for your service to our country in a very difficult time. And I really want to salute you, your Agencies and your staff.

That doesn't mean that at some point, I'm not going to come down like a ton of bricks on all of you, but I really do want to thank you for your service. This has been a very difficult time for everybody, and your staff has done a great job.

Second, just to let you know, Mr. Davidson is on the Zoom with me, and he was one of my prime sponsors on the SAFE Banking Act, the marijuana and banking. We got it out of the House with a huge bipartisan number. It will be in the Senate Banking, and hopefully, Sherrod Brown in the Senate will take it up in some fashion or another, and ultimately, we can deal with the public safety hazards that are caused by so much cash being accumulated by these businesses and the robberies that occur. I just want to alert you all to be ready for that.

Mr. Hsu, in your testimony, you highlighted a concern about overconfidence leading to complacency as a potential that risk regulators need to watch for in the banking sector. One of the examples you used was Archegos, which resulted in $10 billion in cumulative losses.

Can you explain how the OCC and other regulators can promote stronger risk management by these financial institutions?

Mr. HSU. Sure. It is primarily, first and foremost, through the examination process. I think what Archegos shows was a lapse of risk management at a set of institutions, and that risk management is generally well-understood and applied in most cases. I think the risk is that in some instances, there is a bit of a looking askance or weakening of that risk management where there are profits to be made.

That is not everywhere, and that is not every institution. Part of my call for vigilance is both within banks themselves and for supervisors to be vigilant in examining and calling that out and making sure that those weaknesses are identified early before they turn into big losses.

Mr. PERLMUTTER. Thank you. And Mr. Harper, it is a long way from the Financial Services Committee to chairing the NCUA. So, congratulations to you, sir, and happy birthday, by the way.

I would like to ask you about the NCUA's supervision ability as it relates to cybersecurity. You have answered it a little bit in some previous questions, but it is my understanding that NCUA's authority to supervise credit unions' third-party vendors with respect to cybersecurity may have expired in 2001. Is that right?

Mr. HARPER. Yes. We had temporary authority granted as part of the Y2K issue, where we could go in and examine and take enforcement actions against vendors. That authority expired after we got through the Year 2000 event, and we have not had that authority since.

I would say this, that in juxtaposition to our sister Agencies, we are the only one without vendor authority, and the FSOC, and the GAO, as well as our own Inspector General here at the NCUA, have called for us to get the vendor authority so that we can oversee matters like cybersecurity, but also safety and soundness matters, AML, Bank Secrecy Act matters, as well as consumer financial protection.

Mr. PERLMUTTER. Thank you, and I would just encourage all of you, there is what is called the NIST protocol from the National

Institute of Standards and Technology that we hope to get many businesses, the third-party vendors, to start using to try to minimize the potential for hacking and cyber ransomware and all of that stuff.

Again, thank you for your service, and Mr. Chairman, I yield back to you.

Mr. LYNCH. I thank the gentleman. The Chair recognizes the gentleman from Ohio, Mr. Davidson, for 5 minutes.

Mr. DAVIDSON. I thank the chairman, I thank our witnesses, and I appreciate this hearing today.

Vice Chairman Quarles, in your testimony, you mentioned that the Fed is transitioning back to its normal activities and to its normal rulebook, of course, following substantial intervention to provide stability in this past year. Of course, the Fed's primary objectives are to promote low inflation and maximum employment. I would like to focus on the Fed's objective to achieve maximum employment.

Vice Chairman Quarles, the latest economic data from April shows that the labor force participation rate is just under 62 percent. This has been an ongoing challenge, with persistent declines in participation this century, and we have never really fully recovered to the level of participation prior to the 2008 financial crisis.

Furthermore, this is 5 percentage points lower, and has been hard to overcome even in 2017 to 2019. Besides distorting the unemployment data, what are the implications about this lower participation rate for our economy, and how will it influence the Fed moving forward?

Mr. QUARLES. The participation rate is obviously one of the employment measures that we look at closely. For an extended period of time, that participation rate has been under downward pressure just as a result of demographics. As the Baby Boomers age, and age out of the workforce, the overall labor force participation rate is inevitably going to trend downwards.

At the Fed, we have adopted monetary policy both before the COVID event and during the COVID event with an effort to try to support employment as much as would be possible, and we have succeeded in that I think the policies we have adopted moderated, indeed, for a period halted, even minorly reversed that downward trend in the labor force participation rate, notwithstanding the heavy downward pressure from demography.

Mr. DAVIDSON. I thank you for your answer, and I really would look forward to a more extended discussion. As you appreciate, time goes quickly in these hearings. But really, without more participation, we are having to have massive gains in productivity. Otherwise, we can't see GDP growth.

I appreciate the answer, and I just think it is one of the underappreciated metrics that if we rightly look at the labor participation as one of the keys to the mandate, we can see maybe a different policy set. And I think it is also important for my colleagues to consider the implication of many of our fiscal policies on labor force participation.

Some States are wisely rejecting some of the toxic Federal policies that are handicapping our recovery as we seek to rebuild our economy. Some of the bank regulatory policies put a handcuff on being able to make loans to otherwise creditworthy individuals.

Let me transition towards that point. Mr. Hsu, in light of your comments about Archegos Capital today, and other comments today, whom do you believe that regulators should block access to banking or markets? Who should be blocked who would otherwise have lawful access?

Mr. HSU. I don't believe we should be in the position of picking who should be and who shouldn't be blocked. Our focus is on mismanagement and compliance. So, under sound risk management and compliance, we expect firms—because their business models differ. Different banks, different players, we expect them to do due diligence and know who they are dealing with and how they deal with them. And that should be the mechanism through which those decisions are made.

Mr. DAVIDSON. Okay. As Mr. Perlmutter highlighted, we needed to pass the SAFE Banking Act, which we think we did here in the House. We are counting on the Senate getting it across the finish line so that banks can bank people who are engaged in lawful activities in their own States. But that is just the tip of the iceberg.

We have seen bank regulatory policies, under Operation Choke Point, block access to all sorts of markets. And sadly, America has this unfortunate history of people saying, including many regulators, well, you are not going to bank those people, are you? Now, this label of who, "those people," are shifts over time, but I strongly believe that regulators should be, first, consolidated, so that we have one prudential bank regulator, not this whole panel, with due respect to the representation here.

But I think, second, that regulators need to limit their activity to enforcing lawful practices and not creating the force of law with backdoor pressure tactics that might not be a ban or a block, but they have the same effect. We talked a lot about systemic practices. This is certainly systemic.

Ms. McWilliams, as you know, the OCC has conditionally approved a few crypto trust banks. The next logical step would be for these types of institutions to eventually operate as depository institutions. With that in mind, Ms. McWilliams, could you speak to how—

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

Mr. DAVIDSON. —prudential regulators could be on the same page with regulating this space? If you could, please respond in writing, since my time has expired.

Thanks.

Ms. MCWILLIAMS. I will.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Illinois, Mr. Foster, for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

I would like to follow up a little bit more on central bank digital currencies and related things as it refers to the need for a secure digital identity. No matter what your vision is for what a central bank digital currency should look like—whether they are FedAccounts, whether they are a pure crypto asset or whatever—you will still need to know who it is that is transacting.

You need to know this not only in the United States, but if you intend central bank digital currencies to be transacted around the world, you need to have some agreement for an internationally-operative central bank digital currency.

Mr. Quarles, what is the state of international negotiations on how that might work?

Mr. QUARLES. Extremely embryonic. These questions about a digital currency are important, and we are engaging in them, and we are engaging in them with our international colleagues as well through the various central bank fora that exist. But in any jurisdiction, they are quite embryonic, and they raise a number of technical questions such as the one that you have raised here that need to be thought through.

I think we need to do a very careful study of that, not just in this jurisdiction, but globally as well before we would even begin to go down that path.

Mr. FOSTER. But I am sort of struck by the fact that NIST and the international standards organizations actually have fairly advanced technical specifications for how a digital ID might work. These are often called, "Mobile IDs," and that, in fact, some States are rolling those out, as simply a mechanism for putting your REAL ID-compliant driver's license onto your cell phone, using that as a very powerful second-factor authentication.

Internationally, those are working very well, so I am a little bit surprised that you are not trying to leverage that.

Mr. QUARLES. I would say the discussion, again, among the central banks as to whether that would be a mechanism for a central bank digital currency certainly may be sensible, but very premature. We have not been engaging in going down that road, or not going down that road. We are still considering all of these questions.

Mr. FOSTER. Yes. I urge you to proceed with the digital identity problem in parallel with the technical structure of the central bank digital currency. They are really almost separable problems. You have to solve both, and solving them one at a time is not the most efficient way. We have to respond to China and their advance into this area.

Does anyone have any other comments on digital identity? One near-term thing, actually, that we will have to be facing is when we—I think we have a bipartisan agreement to have essentially access to an Internet connection as a guarantee, and the government will be putting many tens of billions of dollars to make sure that is a reality, with one of the main benefits being that you are going to have 30 million more people connected to the Internet.

And one of the big benefits from that is simply to have access, have them now potentially be instead of underbanked or unbanked, they will actually be banked. But of course, these 30 million newbies on the Internet will be ripe targets for fraud. And so, again, it enforces the real need for a coherent approach to digital identification.

Do any of our other witnesses have any comments on how that problem looks, these 30 million newly-banked individuals with rather thin files? Is there a plan for how that is going to work smoothly so we don't see just a torrent of identity fraud?

Mr. QUARLES. I think you can tell from the enthusiastic response of the regulators that you have identified an issue on which we should focus.

Mr. FOSTER. Okay. I'm happy to be of service here, and I will be very interested in following up with your staff. I am surprised and pleased at how far industry has gotten ahead of regulators in terms of the technical standards for high-quality digital ID. And I urge you to try to piggyback on top of that.

My time is now running out, and I would be happy to follow up.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from New York, Mr. Zeldin, for 5 minutes.

Mr. ZELDIN. Thank you to the witnesses for being here today, and thank you, Chairwoman Waters and Ranking Member McHenry, for holding this hearing.

I am going to start off by reading the mission statements taken from each prudential regulator's website. The FDIC's mission is to, "maintain stability and public confidence in the nation's financial system."

The OCC's mission is to, "ensure that national banks and Federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations."

The NCUA's mission is to, "provide through regulation and supervision a safe and sound credit union system, which promotes confidence in a national system of cooperative credit."

The Federal Reserve System's mission is to, "foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems so as to promote optimal macroeconomic performance."

Chairman McWilliams, Vice Chairman Quarles, Acting Comptroller Hsu, and Chairman Harper, would any of you like to share briefly your views on fair access in financial services for legal businesses?

Ms. MCWILLIAMS. I am happy to start, so long as the others follow. Our regulatory response, frankly, to banks serving all legal businesses, as mentioned earlier, has had a little bit of a hiccup in the past, and we have learned from that hiccup, frankly. Our job as regulators is to implement the laws passed by Congress and provide a supervisory framework that considers safety and soundness and consumer protection laws and regulations.

We encourage institutions to serve all legal businesses and individuals in their communities. We have even issued a statement on providing banking services that encourages our institutions to take a risk-based approach in assessing individual customer relationships rather than declining to provide banking services to entire categories of customers without regard to the risks present.

I would say that we have done a lot of work, including extensive examiner training in this area, to make sure that where our examiners look at banks and how banks provide services to different entities is appropriate with the safeguards Congress gave us. And we certainly don't want to be in the business of managing whom the banks choose to bank, so long as they follow the law.

Mr. ZELDIN. And Chairwoman McWilliams, on that point, there is a local business in Suffolk County, New York, my congressional district, the First Congressional District of New York is in Suffolk. They are in the firearms industry, and they have provided to my office letters from multiple lenders all at the same time right now terminating accounts, refusing to extend credit because of a review of business practices.

What is the answer to a lawful business out there in Suffolk County, New York, having multiple lenders terminating their accounts because they are in the firearms business?

Ms. MCWILLIAMS. I would think that those decisions are left at the level of individual banks and how they decide to manage their risk exposures, reputational risk, and everything else. That is not something that we tell them to do or not to do.

I am more than happy to engage with your office to understand exactly—you don't even have to give me the name of the client, but maybe the names of the banks and the notices that have been provided with the name of the bank redacted to make sure that we understand whether this came from the FDIC-supervised banks or one of our sister agencies. I am happy to follow up with you separately.

Mr. ZELDIN. I appreciate that. The four mission statements I read all mention either integrity, confidence, or fair access in financial markets. There can't be true integrity or confidence in the financial system if individuals and businesses are being discriminated against, whether the discrimination is based on an immutable characteristic or a decision to conduct commerce in a completely legal industry.

The financial institutions that are indirectly regulating the livelihoods of legal business owners need to consider the irrevocable damage they are causing to the integrity and confidence in our financial markets, not to mention to those operating businesses themselves.

The public power granted to banks and credit unions in the form of charters and deposit insurance makes perfect sense when it enables the financial services needed for lawful commerce and a functioning economy. But this power is being misused when banks try to regulate downstream markets.

There are legitimate reasons for financial institutions to reassess relationships with customers. These include credit risks or risks related to money laundering. But a political difference or, worse yet, fear of progressive backlash from outside groups is not a good reason. The Second Amendment, as just one example, is not a suggestion. De-banking businesses that legally sell firearms in order to regulate the industry indirectly is wrong.

This is an important issue that requires all of your attention. I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from California, Mr. Vargas, for 5 minutes.

Mr. VARGAS. Mr. Chairman, thank you very much, and you are doing a great job, Mr. Lynch. I appreciate it. I can hear your voice quite clearly, which is great.

I want to thank all of the witnesses again. I appreciate very much you being here.

I joined this committee about 6½ years ago, and when I did, about the only thing that my Republican colleagues wanted to talk about was Dodd-Frank, how Dodd-Frank was awful, Dodd-Frank was terrible. For a while there, I thought that they thought it was the spawn of Satan or something like that because they thought it was so terrible, horrible.

And I wasn't able to listen to all of my colleagues today because there is another hearing going on in the House Foreign Affairs Committee, but I haven't heard Dodd-Frank come up, at least I don't think—I certainly haven't. Maybe it did before.

But Mr. Vice Chairman, Mr. Quarles, you, however, I think bring it up without saying it. On page 1 of your testimony, "Entering the COVID event, the banking system was fortified by over 10 years of work to improve safety and soundness from both regulators and banks themselves." And you go on to describe how we are able to kind of go through this COVID because of some of the rules.

Now what were you referring to when you were talking about this? Was it Dodd-Frank?

Mr. QUARLES. Principally, the higher levels of capital and liquidity that were put into the system post-2008. Some of that was work from the international regulatory community that was coordinated in Basel. Some of that was work at the Federal Reserve. Some of it was mandated in the Dodd-Frank Act.

It was a set of measures. But really, for me, the key issues were the extra capital and liquidity that were in the banking system.

Mr. VARGAS. And I appreciate that very much. Again, it is interesting that we don't hear much about those requirements. Now, the reason I bring that up is because I think the next big one is not Dodd-Frank; I think it is going to be climate change.

When we first started talking about climate change, my friends on the other side of the aisle would first deny that it was going on. Then they started saying, well, it is the cows farting, or I don't know what it was, some ridiculous thing. But now they are starting to accept that it is there, but I don't think they really understand the risk. I don't think we understand the risk.

Chairwoman McWilliams, however, you talk about that. On page 4 of your testimony, you say, "The FDIC expects financial institutions to consider the appropriately addressed potential climate risks that could arise in our operating environment. This includes physical risks associated with extreme weather events such as hurricanes, floods, storms, tornadoes, droughts, and fires." And you go on.

So, you do understand some of these risks then, and you do think they are real?

Ms. MCWILLIAMS. Yes. They are basic safety and soundness practices. And while I would like to think that we are a great regulator, I am pretty confident that both the OCC and the Fed require the same of their supervised institutions.

Mr. VARGAS. And Acting Comptroller Hsu, you wrote, "Climate change possesses new risks and challenges for banks, and we need to make sure they understand those risks and are capable of managing them." I think that is a quote from you?

Mr. HSU. Correct.

Mr. VARGAS. Could you expand on that?

Mr. HSU. Yes, of course. I think it is just as Chairman McWilliams noted, that for safety and soundness purposes, we expect banks to stay on top of these emerging risks. And I think, as you had noted earlier, there are many dimensions to this. For both physical and transition risks, it is complicated. And it is different for different institutions.

I think we in the front need to spend some time investing and understanding what that is to identify, measure, and manage those risks.

Mr. VARGAS. I appreciate that. Again, I appreciate that you are taking this very seriously because I also think, obviously, there are risks and there are opportunities. In California, we are trying to take a look at both because there are opportunities in this transition to a low-carbon economy.

But anyway, I appreciate the work that you have done. I appreciate very much that you are looking at this. It is a big issue. I do have an Environmental, Social & Governance (ESG) bill and others have bills working on the environment issues. And again, I appreciate that you are doing this because I think, a lot like Dodd-Frank, we are going to see that the risks here are real, and we are going to be able, hopefully, to find solutions for them so we don't run into huge problems down the road.

Again, I thank you. I have 8 seconds left, so I will yield back—

[Pause.]

Mr. VARGAS. —to somebody. I am yielding back to somebody.

Mr. LYNCH. Thank you. The gentleman yields back. The Chair now recognizes the gentleman from North Carolina, Mr. Budd, for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman. And again, I thank the panel for being here.

Acting Comptroller Hsu, the OCC has received a number of applications for crypto trust banks, and after conditionally approving three—I believe it was three, you can correct me on that if it is a different number; I think they were Anchorage, Protego, if I have pronounced that correctly, and Paxos. What is the timetable for approving the remaining charters that are out there?

Mr. HSU. I don't know the timetable right now. It is under review. It is under discussion. I just got here. This is my 10th day, I believe. So, we have this in the pipeline to look at. We are not going to drag it out, that I can say. But as that timeline becomes clearer, we can get in contact with your office to let you know.

Mr. BUDD. I would love to stay in touch with you on that. I understand that mastery comes between Day 11 and 12, so good luck with the rest of this. Thanks for what you do.

Another question, and maybe, hopefully, this isn't a Day 11-question, but just your thoughts on blockchain? It offers the possibility of significantly reducing the cost of mortgage origination and consumer lending.

In mortgage origination, we have a company called Figure, and they have applied for a bank charter. And since Figure proposes to take deposits, there is no issue with the litigation over non-depository bank charters. Is that application—if you know about this yet, or if not, we can continue to discuss a few other things. But do you know if that application is on course so that we can set a precedent for other low-cost, blockchain-based financial products?

Mr. HSU. That application is definitely part of the set of applications that are under review. We have had some preliminary discussions about it, but I need to learn more before kind of signaling where that is going. But that is very much under our review.

Mr. BUDD. Very good. I think there is a lot of promise from lowering the cost to consumers, and I look forward to this and to having more discussions on this.

Switching to Vice Chair Quarles, recent media accounts suggest that the Federal Reserve may not grant payment system access to OCC-chartered banks that don't pay deposits, or in at least one case, to State-chartered banks that originated in the crypto industry. Doesn't the Fed grant access to the payment system to non-depository trust banks today, and if so, what is the basis for denying new banks of the same charter type now?

Mr. QUARLES. We do grant access to non-depository trust companies. We recently issued a set of principles to govern account access really for all institutions as a recognition that there is an increasing variety of institutions that are potentially interested in account access. We put those out for comment and are getting comments on them now.

I think what is important—and we haven't made a decision with respect to account access until we develop this framework. We put these principles out. We will get input on them. We will be very transparent about what the rules are. I think that is what is important as these new institutions come for account access.

Mr. BUDD. Very good. Thank you.

Second question, there is a lot of regulatory ambiguity revolving around crypto, and lots of different definitions used by all of the subagencies and respective agencies just adds to that ambiguity. Will you at the Federal Reserve commit to working on a unified definition for what is considered a cryptocurrency?

Mr. QUARLES. As Comptroller Hsu just mentioned, we are engaged with the other agencies in a joint effort to think through some of these crypto definitions and the application of our regulations in crypto areas. I am sure that will be part of it.

Mr. BUDD. There are a lot of joint efforts in this. Do you think you are going to end up coming up with a definition for what is a cryptocurrency? Because that is part of the problem right now, that people don't know exactly what it is, they have different definitions.

Mr. QUARLES. Yes, I think so. We are sort of focused very intently on these crypto issues with the aim of having answers fairly quickly, joint views fairly quickly. I am sure that will be achievable.

Mr. BUDD. I thank each of you for your time. I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Florida, Mr. Lawson, for 5 minutes.

Mr. LAWSON. Thank you, Mr. Chairman. And I would like to thank Chairwoman Waters and Ranking Member McHenry for hosting this important hearing today.

Mr. Hsu, in your written testimony, you noted that the OCC had been monitoring increasing concerns about racial bias in appraisals, particularly in residential lending. I understand the OCC is working with the stakeholders to raise awareness and ensure that banks have the valuation and data to fairly and objectively underwrite these loans. This is very concerning to me.

Can you tell me more about the OCC's work to remedy inherent bias, and what we can do as Members of Congress to make sure that we provide assistance in this endeavor?

Mr. HSU. Thank you. This is a really important issue. I think it has gotten some added press recently, which I think really adds an important—it puts a higher profile on it.

I think this is going to take a lot of work because it is not something that we, the OCC, can directly affect by ourselves. There have been some interagency discussions and some stakeholder discussions, but I don't have all of the details on this. I would be happy to get the folks on my staff who are very knowledgeable on this, who have been monitoring this very closely, to work with folks on your staff to explore options and how to make some progress on it.

Mr. LAWSON. Okay, thank you very much. Because in some instances where an African-American female is getting a house appraised, and you probably know about it—

Mr. HSU. Yes.

Mr. LAWSON. —and she had one of her friends who was a White female go over, and the appraisal was altogether different. And it shouldn't have been that way.

Ms. McWilliams, the COVID-19 virus is having a profound impact on every aspect of American life and the U.S. economy. I saw much of the impact on States, counties, and municipalities. This landscape is to serve that is quoted by the community financial institutions that are part of the Federal Home Loan Bank System: savings and loan; credit unions; Community Development Financial Institutions; and some insurance companies.

In looking at the funding of infrastructure, would broader participation by this nation's Financial Institutions improve the leverage of Federal funding dedicated to infrastructure if, for instance, aligned FDIC-insured institution to put a Federal infrastructure bond to the FHL banks as collateral.

Ms. MCWILLIAMS. Congressman, I'm sorry, there was a little bit of a sound issue, but as far as I understood your question, you are asking about the bonds and how much the FDIC can assist in pledging it as collateral.

It is an issue that, frankly, I don't know how much authority we have in this space, and I am happy to circle back with your office once I can explore that authority and understand the full crux of the question.

Mr. LAWSON. Okay. But anyway, it might be a little more complicated, more than I can acknowledge. It would be great if you can get back to me with some information.

But I would like to go back to Mr. Hsu. I am happy to see in your testimony that while the OCC's 2020 final rule on the Community Reinvestment Act (CRA) took an important step in attempting to improve upon the framework put in place in 1995, you believe there is significant room for improvement.

What necessary steps can the OCC take to strengthen the regulation implemented in the CRA, including options for rescinding and substantially revising the current rules and working with the Federal Reserve and the FDIC on a joint proposal?

Mr. HSU. Thanks for the question.

The first thing we need to do is to carefully study our options. I have instructed staff to consider all options, and one of those options could include rescinding the rule and putting it back out for comment. We have some comments as to how to strengthen it.

And in that process, we could join forces with the Federal Reserve and the FDIC so it is a joint rulemaking. But before we get to that stage, I need to see the analysis about how that can be put out and what the pros and cons of doing that would be.

I want to make sure that all of this is taken into account, and we are just doing it in a measured, deliberative way, because I think everyone agrees that we want to strengthen the CRA. So now, it is a matter of, how do we do that, and how do we do that in a way that is consistent with the Administrative Procedure Act (APA), consistent with the process, and that we hear voices from everybody. It is very important.

Mr. LAWSON. Okay, thank you very much.

And Mr. Chairman, I yield back.

Mr. LYNCH. The gentleman yields back, and the Chair now recognizes the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman. I appreciate the opportunity. I thank the panel for being here as well.

And it is once again disappointing to see the Majority continuing its anti-fintech agenda by proposing legislation that eliminates the OCC's True Lender Rule. A few weeks ago, some of my colleagues were outraged that the Acting Comptroller dared to do his job and defend the Agency's rule, as any Agency leader would.

But what is most ironic about this effort to eliminate the True Lender Rule is that it would hurt the very people whom the Majority supposedly want to help. The biggest beneficiaries of bank-fintech partnerships are consumers with subprime credit or a lack of credit history who don't qualify for a traditional bank loan.

It appears the Majority now supports things that were questionable in the past, like payday loans, because without the fintech, that is what those consumers would be left with if they succeed in their attempts to eliminate marketplace lending. Or in States like Georgia, where payday lending is illegal, there may be no options for these people.

Acting Comptroller Hsu, if the rule is overturned, I hope you will take action to address the legal confusion that will result. I just wanted to make that statement.

Moving on to another topic, Chairman McWilliams, I would like to discuss the FDIC and the other agencies' request for intelligence, the information on financial institutions that used artificial intelligence (AI). I appreciate that this is being done on an interagency basis so that AI policy can be coordinated, which is extremely important in the technology era.

The question is, Chairman McWilliams, what do you hope to accomplish with this request for information?

Ms. MCWILLIAMS. Really, the request is pretty broad, and the request is aimed at understanding exactly what is happening in this space, what do we need to be aware of?

I would say it is a learning expedition where we try to and hope to get a lot of public input to understand what we should be focusing on and how exactly artificial intelligence can be beneficial, and what risks it carries with it. I would say that it is a broad mandate that we hope to accomplish with this interagency product, and we are hoping to be able to implement it in our regulatory standards to allow banks to rely on artificial intelligence to improve their supervision policy, but also how they serve their customers and consumers.

Mr. LOUDERMILK. I appreciate that. And artificial intelligence is a very beneficial tool if it is used in the right way, and it does give the proper results and that we can test those results as well.

Former Democratic Treasury Secretary Larry Summers recently said that central banks are bending to political pressure and stretching beyond their statutory mandate by focusing on climate change in order to be relevant on a current political topic. I actually agree with him on this. The Fed is not supposed to be influenced by political pressure, nor is the Fed the proper venue for climate policy to be made.

Vice Chairman Quarles, do you agree with former Secretary Summers that central banks are engaging in mission creep when it comes to these climate initiatives?

Mr. QUARLES. No, I don't actually think so. Again, I think there has been more made of what is happening on climate change. It is a potential risk that faces the financial sector. As a regulator, we should look at that risk and see what the potential effects on financial stability might be.

Develop, again, an analytical framework so that we don't respond to political pressure, so that we don't respond to headlines, but develop a careful, data-driven framework for looking at a potential risk. That is what we are in the process of doing.

Mr. LOUDERMILK. I would disagree with you on some of these issues because being on the House Science, Space, & Technology Committee, we have heard from many scientists saying that in today's era, while we have done well with climate policies, in the past—I remember in the 1980s, in Los Angeles, you could hardly breathe. It is not that way anymore.

But it isn't the United States of America that is the problem. We are one of the cleanest of the industrialized nations. It is nations such as China and others that are the problem. And I think that is where our focus needs to be. If we are truly interested in local climate issues, then we need to be holding partners overseas accountable, not punishing American businesses in a nation that has done tremendously well in cleaning the environment.

And with that, Mr. Chairman, I will yield back the balance of my time.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from Illinois, Mr. Casten, for 5 minutes.

Mr. CASTEN. Thank you, Mr. Chairman. And thank you to our panelists.

I would like to stay with you, Vice Chair Quarles, and stay on the subject of climate. I am delighted to hear you are focused on the risk being analytical and data-driven. I want to put my friend Mr. Barr at easex, when he said that the Fed doesn't have the authority to regulate environmental policy. I just want to talk about numbers, and I just want to talk about the financial system.

As you know, the rest of the world is leading, and we are now in a following mode. And it is time for us to get back into a leading mode. I would like to just understand a couple of issues, to understand what you all are going to do analytically.

We know from the House Science, Space & Technology Committee, which I serve on with Mr. Loudermilk, that we have significant sea level rise measured in feet, not inches, that is highly likely within the time horizon of current mortgages. As you do your analysis, can you commit to us that you will be factoring in what impact that will have on the banks, on Government-Sponsored Enterprises (GSEs), and on the insurance industry?

Mr. QUARLES. The answer is, yes, because we have long taken into account in supervising institutions in particular geographic locations, the risks of those geographic locations. As we continue to get more data and to learn more about the evolution of the environment as additional risks become clear, we will ensure that institutions are including them in their risk management and that we include that in our supervision of their risk management.

Mr. CASTEN. I just want to point out that, and I understand we are all being cautious because these are uncertainties, there is a real gap when I sit on the Science Committee, and I ask, "What cities are you concerned about?" And they say, "The entire Eastern Seaboard." And then, I move to the Financial Services Committee, and they say," We are thinking about it." These changes are coming, and we have to grapple with them.

Second question, S&P announced in January that it was placing 13 major oil and gas companies on credit watch, negative credit watch due to energy transition risks. Will your analysis consider the debt and equity risk if that goes away, and what is going to happen to the holdings within the banks you regulate?

Mr. QUARLES. We are developing the framework currently to be comprehensive, but any placing of any institution's exposures on credit watch is and will be taken into account in supervision of institutions that are exposed to those firms.

Mr. CASTEN. Okay. My concern, having come from the energy industry, is that there is some measurable cyclicality in the energy industry. And you can kind of watch like clockwork that the holdings in the regulated banks when there is a negative cyclicality get moved into their non-bank holdings, and all of a sudden, the bank says, "I have an opportunity for you to invest in energy special projects Fund V." And we all understand what they are doing, but that gets it out of some of the areas in which you might have direct regulatory supervision.

As you do this analysis, will you be looking to make sure that those assets that are encumbered as banks try to move risk into areas that may not be subject to Dodd-Frank supervision or the regulatory regimes, can you commit to making sure that we keep an eye on those non-bank actors as well to understand where money is moving throughout the entire economy?

Mr. QUARLES. That is because the Federal Reserve is a holding company, an umbrella supervisor. It does look at the overall organization and not only the depository institution subsidiary. So, yes, when we take a look at the capital position or the overall position of the firm, we take into account the risk position of the firm. We look at the overall firm.

Mr. CASTEN. Okay. I would welcome the chance to work with your office on that. We are spending a lot of time thinking about it. And as I said at the start, I think we ought to get behind the eight ball.

Acting Comptroller Hsu, you mentioned in your opening comments that you—I think you have been joining the Network for Greening the Financial System. Can you just share with us a little bit of why that is so important, and what kind of leadership you are seeing in an international framework that we need to get up-to-speed on in our country?

Mr. HSU. I think the primary purpose is to learn. That forum was created in order to allow and to facilitate central bank supervisors from around the world, and they have a lot of members who come and say, here is what we are seeing, here are some best practices, here is what we are dealing with. And the idea for us is we don't want to reinvent the wheel. If someone else has come up with a good approach to these risks that we have been talking about, we want to leverage that as quickly as possible, kind of integrate that and apply it in a tailored fashion to our institutions which are going to have to deal with these risks.

Mr. CASTEN. Thank you, and I will yield 11 seconds back to the Chair. I appreciate your time.

Mr. LYNCH. I thank the gentleman. The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas, for 5 minutes.

Mr. LUCAS. Thank you, Mr. Chairman. I appreciate the opportunity to visit with our panelists today. And I also appreciate the opportunity to follow a couple of my colleagues on the Science Committee.

In her March testimony before this committee, Secretary Yellen highlighted, following along on these lines, that climate change is a top priority for the Biden Administration and that regulators should be assessing risk to financial institutions. As any regulator who has appeared before this committee for the last 26 years knows, the Third Congressional District of Oklahoma, which I have the proud privilege of representing, is a commodity-driven economy, centered on agriculture, and centered on energy.

The actions of the Fed, the FDIC, and the OCC have a real and significant impact on the businesses in my district which are capital-intensive. We have to have major resources to do the kind of amazing things we do.

I will start with Acting Comptroller Hsu. In your testimony, you explain that the OCC will act on the climate issue or risk with a sense of urgency. Can you describe to me the ways in which addressing climate risk could manifest themselves in your supervisory and regulatory requirements? What is coming toward my constituents?

Mr. LYNCH. Could the gentleman suspend?

Mr. LUCAS. Absolutely.

Mr. LYNCH. Mr. Lucas, could you turn your camera on? Under the House Rules—

Mr. LUCAS. I'm sorry, Mr. Chairman, and I apologize for that. I thought I had it on.

Mr. LYNCH. Okay.

Mr. LUCAS. Sorry, Mr. Chairman.

Mr. LYNCH. The witness may proceed. Thank you.

Mr. HSU. Different financial institutions will be exposed to climate risk differently. And what we want to ensure is that they are appropriately—that they know what their risks are. In some cases, there will be a lot. In some cases, there will be a little.

It really depends—and some of these are physical risks, and some of these are what they call transition risks. What was highlighted earlier, that these are real things, and we just want to make sure that banks are identifying those and measuring those not with the desire or an eye toward putting the thumbs on the scale for different industries.

Mr. LUCAS. But how you identify those risks, how you put your thumb on the scale, all regulators, has a dramatic effect on the cost and availability of capital. We can drive capital decisions in this country away from very successful, ever more efficient environmentally conducting themselves sectors by how we do this.

I have watched this before. That is why I asked my question, and I ask all of you to be very careful in what you do. The goal is not to use financial regulation to create someone's version of the world. The goal is to assess the risk so that the market economy can incorporate the demand from the public for a cleaner environment and proceed in that direction.

That's just an observation from someone who is mildly sensitive about the effects of the Federal Government on his constituents going back to the 1930s.

Next question, some sectors of the U.S. economy are seeing a surge in consumer prices. It is a result of high demand outpacing supply. This could be temporary, or these price pressures could continue to build.

Vice Chairman Quarles, in September of last year, a market survey conducted by the Federal Reserve Bank of New York showed that less than 25 percent of the respondents cited inflation as a risk for economic stability. If we would do that survey right now, do you suspect the results might be a little different?

And I come at this as a person who was in college in the late 1970s and early 1980s who was starting to farm, who went through that inflationary period. If you are under 40, you don't remember how bad it can be.

Touch on that for a moment, if you would, Mr. Vice Chairman?

Mr. QUARLES. It is kind of you to implicate in any way that I might be under 40. I do remember that heavy inflation.

I don't think I want to speculate on what a poll currently would say, but I will say that we do expect to see inflationary pressures over the course probably of the next year, certainly over the coming months. Again, I think that our best analysis is that those pressures will be temporary, even if significant, but if they turn out not to be, we do have the ability to respond to them.

Mr. LUCAS. I just remember the vicious correction that went on in the early 1980s, as the economy picked up and the velocity of the economy increased and the dramatic expansion of the monetary supply. We have only put, what, $8 trillion of extra money into the economy in the last year-and-a-half? You have to survive whatever comes.

I yield back the balance of my time, Mr. Chairman.

Mr. LYNCH. The gentleman yields back. The Chair recognizes himself for 5 minutes of questioning.

Acting Comptroller Hsu, you said in your testimony that the OCC will undertake a review of recent actions that the OCC has taken in the fintech space, and that includes actions on cryptocurrency assets and [inaudible] systems.

And specifically, you state that you have a concern that providing the special purpose charters that were proposed by your predecessor in part—

Ms. GARCIA OF TEXAS. Excuse me. Mr. Chairman, we are having trouble hearing you. There is an echo.

Mr. LYNCH. —will convey the benefits of banking without commensurate responsibility. What are your thoughts?

Mr. HSU. I didn't catch your whole question, but I think I have the gist of it.

I believe that we do have a risk where on the one hand, there is a thought that if we simply charter the institutions, if we bring them into the regulatory prism, it will be fine, that that is the proper thing to do. I think there is a risk with that. I think that is easier said than done.

At the same time, I do feel like there is a strand of thought that, well, we just won't charter any of them, right? We will stick by our guns as to where things are. And I don't think that is the right answer either because it is not going to make it go away. It is simply going to happen outside of the regulatory purpose.

We need to figure out a way where we can do this in a safe and sound way, where we can adapt to the innovation. The innovation is happening, whether we want it to or not. So, I believe we need to approach that smartly, which is why we are kind of re-reviewing this to make sure that balance is being struck in the right way and that we are doing it together.

Because this is happening not just at the OCC, it is happening in other spaces as well.

Mr. LYNCH. That is great to hear. That is very comforting. And I think I can speak for the other Members in saying there is a real spectrum of opinion with respect to fintech and the impacts of banking and how fintech fits into the existing banking infrastructure and how it serves our constituents.

But one thing I do want to point out is that in the past, I don't think the other Comptrollers of the Currency have really engaged Congress. They certainly haven't engaged this committee. I Chair our Task Force on Financial Technology, and there are a lot of people on this committee who are well-informed, I think, and excited about the possibilities. So, if I could just offer a bit of advice, please engage us.

I think it would help with the thoroughness and the precision that we all need on that issue, and also you would garner the perspectives of all of the members on this committee in devising the solutions that we all believe we need. We have a wonderful financial system. The United States markets are the envy of the world.

We would like to make progress without damaging the existing integrity that we have going forward.

That is all I have, and I will yield back.

The gentleman from Tennessee, Mr. Kustoff, is now recognized for 5 minutes.

Mr. KUSTOFF. Thank you, Mr. Chairman, and thanks to the witnesses for appearing today. Vice Chair Quarles, if I could go back to you and maybe follow up a little bit on Congressman Lucas' questioning, we saw last month, in April, a 4.2-percent increase, pursuant to the Department of Labor report, in consumer prices. You all in your last discussion have termed inflation, "transitory." Let me, if I can, follow up and ask you to characterize, if we see rates, inflation continue as it has for the next several months, at what point does inflation cease to be transitory or, the corollary, how long do you expect inflation to remain transitory?

Mr. QUARLES. I don't and we don't have a projection for how long is too long. I do think that it is important for us all to keep in mind, as was mentioned earlier in the hearing, that last month's very high inflation reading was the highest since 2009, and yet after 2009, we went through an extended period of extremely low inflation, well under the Fed's target. I don't think that we can say that 1 month, or 1 quarter, or 2 quarters or more is necessarily too long. We do expect to see higher inflation for some period of time.

Now, it is possible that going through a period even of transitory inflationary pressures over that kind of a period could lead to some change in expectations. I don't expect it, but if it were to happen that a change in expectations led to a more durable inflationary environment, then the Fed has the tools to address it. For me, it is a question of risk management. This is the best analysis we have currently: inflation will be temporary. What if we are wrong? If we are wrong, do we have the means to keep it from getting out of hand? We do, and history would tell us that the economy is unlikely to undergo these inflationary pressures for a long period of time.

Mr. KUSTOFF. You referenced, "some period of time," so I am going to ask you to further define what, "some period of time" is. And I will give you one particular point of context, and that is from my REALTOR and home building community in my district in West Tennessee. And I suspect this is similar to what 434 other Members of Congress are hearing, that their real estate market is red hot, that they get multiple offers for different listings, and that is for existing homes. The home builders say that lack of labor and rapidly-increasing cost of lumber, up 300 percent over the past year, makes it almost prohibitive to build homes. With the response you just gave me, how much longer can we expect that to continue, and at what point does the Fed need to say, enough is enough?

Mr. QUARLES. I can't give you a projection for how much longer that is going to continue because we are coming out of an unprecedented event. There is not sort of a series of historical experiences that one could point to to say, this is how long inflationary pressures last after you have shut down the economy in the face of something like COVID. The question is, what should the Fed do about it? Our experience over the course of the last decade coming out of the financial crisis is that a couple of times we thought we wanted to stay ahead of inflationary pressures, and increased interest rates. It was premature, and I don't think actually that it would be good for the industries that we want to see thriving as the recovery continues, for us to close off that recovery prematurely trying to stay ahead of inflation when, again, our best estimate is that we are not behind.

But we could be wrong because this is an unprecedented situation. For me, the question is, are we prepared in case this turns out to be a more durable event, and I think the answer is, "yes," but I do think that if we were to try now to stay ahead of the inflation curve, we could end up significantly constraining the recovery curve.

Mr. KUSTOFF. That is the end of my time. I yield back, and I appreciate your response.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentlelady from Texas, Ms. Garcia, for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Mr. Chairman, and thank you to all of the witnesses who are joining us today.

Access to the banking system is a critical step in building access to credit and, thereby, access to wealth building, but there is still a high percentage of unbanked individuals. My district is 77-percent Latino, and it includes many people whose preferred language is not English. Last week, my bill that would make it easier for borrowers to get their mortgage loan service in their preferred language passed out of this committee. The Improving Language Access in Mortgage Servicing Act, is just the first step. There is much more work to be done. As Americans, it is important that we work to facilitate economic inclusion at all levels, including, but not limited to, language diversity. We must continue providing resources so that institutions can better serve their diverse populations.

A recent study on Latino entrepreneurs found that only 20 percent of Latino-owned businesses that applied for a national bank loan over $100,000 obtained funding, compared to 50 percent of White-owned businesses. This lack of capital has forced many Latino-owned businesses to take on riskier loans against their will, and this problem must be addressed now because the Latino market for financial services is growing every single day. Latino-owned businesses have grown 34 percent over the last 10 years. We need to make sure that diverse consumers have equal access to capital.

I look forward to seeing the enactment of Dodd-Frank Section 1071 and an updated CRA, but I want to take a holistic approach at financial inclusion in our society. My first question is for Vice Chair Quarles. Can you talk about the cultural, systematic, or language barriers that prevent large banks from making room for diverse consumers?

Mr. QUARLES. First, ensuring that there is broad access to financial services for all customers is an important part of our supervisory responsibilities as regulators. Language access is clearly an important part of that. In areas where there are significant parts of the population who don't speak English, we do that and we include that in our supervision. And we have data collection from small businesses as well for information on the overall access to the economy of those whose first language is not English.

Ms. GARCIA OF TEXAS. Right. What steps are you all taking to make sure that there is access to capital?

Mr. QUARLES. As I said, that is part of our supervisor engagement with firms to ensure that all of the issues that may be obstacles to making financial services available on a fair basis to all consumers in an area are addressed, and language accessibility would be part of that.

Ms. GARCIA OF TEXAS. Right. I'm sorry. I know that is your role and it is your responsibility. My question is, what exactly are you doing to meet that responsibility?

Mr. QUARLES. We supervise the firms to ensure that they address the question of language accessibility.

Ms. GARCIA OF TEXAS. Okay. And in your supervision, what is it that you look for? What is it that you raise a red flag on? What is it that you use as a good model for others to follow? Could you give me some examples of what you do in your supervisory role to make sure that there is diversity in language inclusion?

Mr. QUARLES. It sounds as though you want a level of concreteness that we will send something up to you on. It is part of our fair lending and CRA examinations on every institution, but we could send you something at a more granular level.

Ms. GARCIA OF TEXAS. Right, and remember—

Mr. QUARLES. I don't do supervisions myself, so we should have the supervisors provide you with detailed analysis and what it is that we do.

Ms. GARCIA OF TEXAS. Great. I look forward to receiving it. And, Mr. Chairman, I only have about 20 seconds, so I just wanted to ask quickly, Chairwoman McWilliams, what is it that we could be doing more of to ensure that the programs, like the Mission-Driven Fund, are targeted to communities with language barriers?

Ms. MCWILLIAMS. Oh, thank you for the question, and it may come as no surprise to you that I have a little bit of experience reading forms in a non-native language on a daily basis.

Ms. GARCIA OF TEXAS. That makes two of us.

Ms. MCWILLIAMS. So, you know my pain. I am happy to provide a response in writing to you, or even meet, if you want to meet on this topic.

Ms. GARCIA OF TEXAS. Thank you. I yield back, Mr. Chairman. I have run out of time.

Mr. LYNCH. The gentlelady yields back. The Chair now recognizes the gentleman from Indiana, Mr. Hollingsworth, for 5 minutes.

Mr. HOLLINGSWORTH. I appreciate the attention and I appreciate all of the witnesses for being here today. Vice Chair Quarles, I wanted to come back to your answer to Mr. Kustoff's question earlier. I thought you put it extremely well in making sure that you are finding the right balance between not constraining the recovery, but also, down the field, paying attention to the inflation risk should it become durable. I think that is very, very important. I know there is a lot of concern about this right now. I hope that concern remains transient, but I think that your focus on ensuring that this robust recovery that we are seeing continues unabated is really, really important. So, thank you for that very thoughtful answer.

I wanted to turn my attention to a potential proposal that is being discussed by my colleagues across the aisle. I noted that in your testimony, you said the banking system is more liquid and better capitalized compared to last year. Certainly, I have heard a lot of concerns from borrowers, and I have heard a lot of concerns from lenders over the last couple of months. One thing I haven't heard about, though, is the significant excess of bank lending that has led to a disconcerting weakening in the creditworthiness that they are underwriting. Yet, I understand that one of the bills being considered by my friends across the aisle is one that would tie mechanistically, without discretion, increases in the counter-cyclical capital buffer to the increases in the Fed Funds Rate.

I really oppose this effort, and I wondered if you might talk a little bit about what you are seeing out in the environment right now, and talk a little about the variety of reasons you might increase the Fed funds rate, not specifically correlated with excess bank lending or a weakening of creditworthiness of sponsors, et cetera.

Mr. QUARLES. Yes, I think that both prudential and macro-prudential supervision, while there are connections, they aren't algorithmically related to our monetary policy. And there may be circumstances in which a change in monetary policy could lead to developments in the financial sector that would cause us to say, okay, time to take some macro-prudential steps, but others when they would not.

We were making changes in monetary policy in the lead-up to March of 2020. We have done that. It would have been a mistake at that time to turn on the Countercyclical Capital Buffer (CCyB) to be concrete because when we went into the event, the problem was not a shortage of capital. The problem was, in fact, that we needed to turn down some of our capital measures in order to allow the system to use the capital that it had to continue to support the economy through that stress.

Mr. HOLLINGSWORTH. I think just to summarize what you very articulately put, though, is that moves in the rate may be correlated with weakening in credit standards by depository institutions, but that correlation is not perfectly done, and there are a panoply of reasons why you might raise rates that are unrelated to weakening credit standards or excess bank lending. Is that fair?

Mr. QUARLES. Yes, absolutely.

Mr. HOLLINGSWORTH. Great. My second question I just wanted to ask quickly is, earlier this year I sent a letter with a few of my colleagues asking for an update on margin eligibility requirements for a segment of OTC securities. As you know—we have talked about it many times—these rules haven't been updated since 1999. I know that you sent me a response. That response was, "We are going to get around to it." We have been waiting for a long time for you to get around to it. Do you think that we are going to see progress on updating the proposal for updated margin eligibility requirements?

Mr. QUARLES. We are continuing the interagency discussions around that. As you know, one of the elements of the statutory framework is that we also consult with the SEC. I think there are some additional recent events around sort of margin exposures on securities, and the general review of the margining framework has caused us to think that we need to incorporate this into that. So, it is not falling behind the refrigerator and been forgotten about, but it is, I think, part of a larger discussion.

Mr. HOLLINGSWORTH. Great. Last question, and it may be a little bit lengthier one, but for the time we have, is there is a real reason to believe that with economic growth in excess of 6 percent, and although we are seeing inflation on the rise, hopefully, in a transient sense, that the experience for the consumer, as wages continue to rise, even in the face of prices, that people are really mostly concerned about the real differential between their wages and inflation, not just concerned about kind of what the inflation rate is in an absolute sense?

Mr. QUARLES. I think that is part of the expectations question: Are inflationary expectations being affected by the pressures that we will see over the course of the next several months on prices and wages? It is a possibility. I continue to think that it is not the probability.

Mr. HOLLINGSWORTH. Thank you for your time. I yield back.

Mr. LYNCH. The gentleman yields back. The Chair now recognizes the gentleman from New York, Mr. Torres, for 5 minutes.

Mr. TORRES. Thank you. I have a question for the regulators regarding the Archegos collapse. When I think about the collapse, it raises the question of how so many banks can give so much leverage to one financial institution betting on so few underlying stocks. And I am wondering, in light of the Archegos collapse, are any of you planning to put in place rules requiring greater disclosure in relation to derivatives, in general, and credit swaps, in particular?

Mr. QUARLES. I can start on that. We certainly, in light of the events that we saw, are reviewing both our regulatory and our supervisory framework to ensure that it would be hard for that to happen here. I do think that it is important to keep in mind that the great bulk of the losses that were incurred in connection with Archegos occurred outside the United States. They were not within the U.S. regulatory perimeter. The firms that were within the U.S. regulatory perimeter did not lose, one firm did, but the great bulk of the firms did not lose money, which indicates that our supervisory stance, with respect to those firms and our regulation of those firms, is actually probably not materially deficient.

But whenever you see something like that, even if it occurs in another part of the world, you want to make sure that you—

Mr. TORRES. If I could interject, why not have greater transparency? As a layperson, I ask myself, is it responsible as a matter of risk management for banks to enter into credit swaps with Archegos without knowing all of the credit swaps that Archegos had entered into, and without knowing that Archegos had bet on only a few stocks? In all of those credits swap contracts, it seems, to me, financial institutions have an interest in knowing whether a company like Archegos is sufficiently capitalized and excessively leveraged.

Mr. QUARLES. But that is exactly what we are looking at. The point that I was making is that those are perfectly reasonable points. We are looking at them currently. They did not result in material losses in the U.S. financial system. Our supervision and regulation of these firms did not result in those losses, but it's perfectly fair to ask, what can we learn from the fact that it happened elsewhere? Are there changes we should make? Those are perfectly fair questions, and we are looking closely at it.

Mr. TORRES. Do you think if there had been greater disclosure around the over-leveraged position of Archegos, that those losses could have been prevented?

Mr. QUARLES. As part of the risk management of the firms, I do think that the prime brokers should have a clear view of, when they are taking collateral against something, are there risks to that collateral position that can't be told simply from their own exposure? And it does appear that these firms, although that wasn't something that was happening, again, within the U.S. regulatory perimeter, that does appear to be something that these firms, where they took the losses, were not doing.

Mr. TORRES. I know that Archegos, as a family office and as a result of the credit swaps, was exempt from the Section 13(f) reporting requirements, but the banks that bought stocks on behalf of Archegos were subject to those requirements. Did your office review the 13(f) filings, and did you notice that multiple banks were buying an unusually large volume of the same stock? Did you see those red flags in advance of the collapse?

Mr. QUARLES. Since the exposures were not within the U.S. regulatory perimeter, no, it would not have been possible for us to. That was something that was happening elsewhere, but it is something that we are looking at how to ensure that were something like that to happen within the U.S. regulatory perimeter, that we are on top of it.

Mr. TORRES. And Archegos was a family office. Do you think the failure of Archegos should lead us to rethink how we approach family offices with respect to financial regulation? I know there was a carveout for family offices within Dodd-Frank based on the assumption that family offices would make conservative investments, but there was nothing conservative about the behavior of Archegos. Should our approach be re-thought in light of this experience?

Mr. QUARLES. I would think it would be premature to say that. If the banks that had exposure to Archegos had themselves done a better job of risk management, they would have known what those exposures were. They would have extended less credit on the basis of any particular collateral. That is not within the Federal Reserve's sort of regulatory ambit. It would be something for others to look at, but I wouldn't jump to that conclusion from this event. I would jump more to a conclusion that the bank needs to manage its procedures.

Mr. LYNCH. The gentleman's time has expired. The Chair now recognizes the gentleman from Ohio, Mr. Gonzalez, for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman, for holding this hearing today, and I certainly appreciate the testimony of our witnesses. Mr. Quarles, I am going to stay with you with my line of questions and stick to the LIBOR topic, and I know the Fed has a strong focus on ensuring effective transition away from LIBOR to alternative reference rates. As you know better than most, this is a fairly complex undertaking, but one that is proceeding, which is nice to see. I also understand the Fed supports the recently-announced proposed extension of U.S. LIBOR, which will provide us with a transition. Alongside the extension, I personally believe there is more that we can do with respect to these legacy contracts, and I think you share that view. Can you please elaborate on your plan, moving forward, to facilitate greater certainty with respect to this long-tail legacy issue, and do you believe that, ultimately, congressional action is necessary?

Mr. QUARLES. The short answer to the last question is, yes, I do think congressional action will be necessary. The extension of the provision of LIBOR that you noted will allow the bulk of the legacy LIBOR contracts to run off between the end of this year and 2023 because we are insisting now that firms not write new LIBOR contracts after the end of this year, but by bulk, that is probably about 60 percent. Maybe it is a little more than 60 percent, so at least 30 to 40 percent of legacy contracts will need to be renegotiated, and that renegotiation could be difficult. They may have existing fallback language, but fallback language may not be satisfactory, and there is really no way to address that other than legislation.

There is New York legislation, but not every contract is under New York law. There are some questions about how that works with some contracts that raise SEC issues. Federal law would be an important part of how to address that tough legacy.

Mr. GONZALEZ OF OHIO. Thank you. And in terms of fallback language, where contracts are silent or where a new reference rate has not been agreed to between the parties, presumably, in our Federal legislation, we would want one standard, correct? We wouldn't want a set of standards necessarily because we want certainty in the market, or do you have a different position on that?

Mr. QUARLES. We want clarity. I suppose, conceptually, you could obtain clarity in a number of ways. I do think that when you are trying to deal with something as complex as the LIBOR transition, a single standard is helpful just as a matter of logistics. I wouldn't want to say in this context that you can't think of another way to provide the necessary clarity.

Mr. GONZALEZ OF OHIO. Thank you. And then I want to switch to central bank digital currency (CBDC). I would love to hear your perspective. Obviously, China started rolling out theirs. I don't know if you saw this morning—I am sure you did—their announcements with respect to cryptocurrencies broadly and the effect that is having on those crypto markets. How do you see the central bank digital currency question vis-a-vis the United States and our role as the global reserve currency, but also its role in the financial system?

Mr. QUARLES. Beginning with the caveat that those are complicated questions that I wouldn't want my answer today to be viewed as final or definitive on, I think that the factors that cause the dollar to be the world's clearly central reserve currency will not be significantly affected were we to develop a central bank digital currency. I don't think that we are falling behind China or having the role of our currency internationally threatened by the measures that China is taking currently to digitalize their currency. We want to stay on top of that. We want to understand what other jurisdictions are doing. We want to understand what the role of a CBDC could be in our own domestic economy. There are a lot of things to study there. We could end up doing it, but I don't think that the driver of that decision should be that we think that there is a live threat from the technology around the currency to the dollar's reserve status.

Mr. GONZALEZ OF OHIO. What do you think would drive that decision ultimately?

Mr. QUARLES. I think we need to see whether there are efficiencies in the payment system, both domestically and internationally, that could uniquely be addressed or very usefully be addressed by the central bank providing a digital currency. In many cases, that might not be. We do have a very heavily electronic and, in many ways, [inaudible] payment system.

Mr. GONZALEZ OF OHIO. Thank you, and I yield back.

Mr. LYNCH. The gentleman yields back. The Chair recognizes the gentlelady from North Carolina, Ms. Adams.

Ms. ADAMS. Thank you, Mr. Chairman. Chairwoman McWilliams, as you know, the FDIC is known by many for its role in insuring deposits, but it also plays a key role in consumer protection. The FDIC has stated that it is responsible for evaluating supervised instructions for compliance with consumer protection, anti-discrimination, and community investment laws, among other duties. However, it appears that FDIC-supervised banks are now skirting the line of compliance with consumer protection. So let me ask you, given the FDIC's stated role in the identification and the elimination of dangerous and discriminatory practices, what steps is the FDIC taking to make sure that banks are not using partnerships with fintech companies as a back door to reintroduce predatory tactics?

Ms. MCWILLIAMS. I can assure you, Congresswoman, that we don't take consumer protection lightly, and I would be more than happy to engage with your office to understand the specific instances where you believe that FDIC-supervised banks have been able to skirt consumer protection laws with impunity, because I can assure you, that has not been the case, at least not under my chairmanship.

I think there is a lot of misinformation about the fintech partnerships. I think one of the prior colleagues of yours mentioned the benefits of having fintech partnerships in terms of the benefits to consumers. We have a large proportion of the United States population who cannot afford $400 on a monthly basis for family emergencies, and in those cases, you want to have access to credit available to them. And quite often, the fintechs are able to provide different methodologies to be able to bank consumers with lower credit scores, so I think there are a lot of benefits.

What I believe you may be referring to is a rulemaking that we promulgated, which is the Value-When-Made Rule, and this particular rule, I believe there has been a lot of misinformation about it. It does not expand paydown lending in FDIC-regulated banks. It does not authorize the use of a bank charter for other arrangements. And we have spoken very openly about viewing unfavorable entities that partner with a State bank to evade, so if that is what you are talking about, I am happy to engage in explaining the rule.

Ms. ADAMS. Okay. We will do that. Thank you so much. Acting Comptroller Hsu, as you know, the OCC plays a key role in ensuring that banks by the rules. However, recent reports indicate that banks are rapidly expanding their partnerships with financial technology companies that may rely on predatory lending practices. We have some examples, but let me ask you, does it concern you when a national bank you regulate teams up with another company to engage in risky lending that has been shown to generate discriminatory outcomes?

Mr. HSU. Yes, absolutely. Discriminatory outcomes should not be an outcome for any bank, especially for a national bank, so, yes. Now, I do think there are some partnerships that are healthy, and there are some partnerships that are unhealthy. And our role is to ensure that those partnerships that are healthy, that they are not leaning towards predatory lending or those kinds of outcomes.

Ms. ADAMS. Okay. Would you be concerned if a national bank partnered with a fintech lender that claimed its products are neither loans nor credit in an attempt to evade Federal and State consumer financial laws?

Mr. HSU. I think it depends a lot on the facts and circumstances. If there are particular instances, we would be happy to look at those and make sure that they are doing the right thing.

Ms. ADAMS. Okay. Actually, Comptroller Hsu, do you have any reservations that a bank under your supervision is renting out its charter so that tech startups can employ these risky practices?

Mr. HSU. Yes. I should reiterate, predatory lending and rent-a-charter, there is no place for that in the national banking system.

Ms. ADAMS. Okay. In light of what we have discussed today, do I have your commitment to carefully examine partnerships between banks and fintech startups, and, in particular, to scrutinize instances in which banks and new student loan companies are maybe teaming up to make an end run around consumer protections?

Mr. HSU. On student loans, I need to check with my staff as to the specifics on that, but, in general, yes. My understanding is that there is guidance and there are rules around this, and we would expect banks to follow those, and our examiners would examine for that.

Ms. ADAMS. Okay. Thank you.

Thank you very much. Mr. Chairman, I yield back.

Mr. LYNCH. The gentlelady yields back. By prior agreement between Chairwoman Waters and the witnesses, we have a hard stop at 1:30, and we are just past that right now. First of all, I want to thank our Members for their really thoughtful questions. This was a great hearing. I also want to thank our distinguished witnesses for their insightful answers and for their testimony today.

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

And with that, this hearing is now adjourned. Thank you.

[Whereupon, at 1:35 p.m., the hearing was adjourned.]

# A P P E N D I X

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Statement by

The Honorable Todd M. Harper

Chairman, National Credit Union Administration

before the Committee on Financial Services

U.S. House of Representatives

"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"

May 19, 2021

Chairwoman Waters, Ranking Member McHenry, and other Members of the Committee: Thank you for inviting me 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). As a former congressional aide who spent more than a decade working for the House Financial Services Committee, I am deeply honored to be here with you today.

After more than 20 years of working on financial services policy issues, I have come to believe that effective financial institutions regulators like the NCUA need to be:

- fair and forward-looking;
- innovative, inclusive, and independent;
- risk-focused and ready to act expeditiously when necessary; and
- engaged appropriately with all stakeholders to develop effective regulation and efficient supervision.

This regulatory philosophy is my North Star, and it is guiding the agency's response to the COVID-19 pandemic's economic fallout and positioning the NCUA for future challenges. This regulatory philosophy has also informed my priorities for the agency, including capital and liquidity, consumer financial protection, cybersecurity, diversity and inclusion, and economic equity and justice.

In my testimony today, I will first focus on the state of the credit union industry and the National Credit Union Share Insurance Fund before turning to the NCUA's response to the COVID-19 pandemic's economic fallout, with a particular emphasis on the road ahead. I will also highlight several recent rulemakings, as well as the agency's efforts to advance diversity and inclusion, improve consumer financial protection, and advance economic equity and justice. I will then conclude with several legislative requests related to vendor authority, flexibility in managing the National Credit Union Share Insurance Fund, and permanently extending the temporary enhancements of the Central Liquidity Facility.

## State of the Credit Union System

Although the pandemic and its associated contraction in economic activity influenced credit union performance throughout 2020, the credit union system has remained on a solid footing.

As of December 31, 2020, there were 5,099 federally insured credit unions, 2.6 percent fewer than a year earlier, and membership increased 3.3 percent to 124.3 million.[1] The number of federal credit unions declined by 3.0 percent over the same period to 3,185, and the number of state-chartered credit unions declined 2.0 percent to 1,914. The decline in the number of credit unions mainly resulted from the long-running trend of consolidation across all depository institutions, which has remained relatively constant across all economic cycles for more than three decades.

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[1] See March 4, 2021 Quarterly Credit Union Data Summary

Total assets in federally insured credit unions rose by $278 billion, or 17.7 percent, over the year ending December 31, 2020, to $1.84 trillion. Credit union shares and deposits rose by $268 billion, or 20.3 percent, to $1.59 trillion, reflecting the CARES Act's stimulus payments and the sharp economy-wide increase in personal savings. The credit union system's net worth increased by $12.1 billion, or 6.8 percent, over the year to $190.3 billion.

Strong asset growth in 2020 led to a decline in the aggregate net worth ratio from 11.37 percent to 10.32 percent. Nevertheless, the credit union system remains above the statutory well-capitalized requirement of 7 percent.

The overall liquidity position of federally insured credit unions also improved during 2020. Cash and short-term investments as a percentage of assets increased from 13.0 percent to 18.0 percent, reflecting a 69.0 percent increase in cash and short-term investments, from $201 billion as of December 31, 2019, to $340 billion as of December 31, 2020.

In recent months, economic conditions have improved and the outlook for the year ahead is generally favorable. Credit union performance, however, will continue to be shaped by the fallout from the pandemic and associated recession. The NCUA is actively monitoring economic conditions and assessing these and other risks to credit unions, their members, and the Share Insurance Fund.

**Factors Affecting the Industry in 2021**

Looking ahead, the top priority for the NCUA is ensuring that the credit union system and the Share Insurance Fund are prepared to weather any economic fallout related to the pandemic. To protect the Fund, the agency is actively monitoring certain segments of the system, including credit unions closely connected to the oil and gas, travel and leisure, and agricultural sectors, among others. The agency is also focusing on credit unions with elevated risks, such as those with large concentrations of commercial real estate loans relative to assets.

As during past recessions, it is likely that credit union performance will trail any improvement in the labor markets by one to two years. Accordingly, system-wide delinquency rates, which remained low through the end of 2020, could begin to rise as forbearance programs end. To prepare, credit unions will need to continue to pay careful attention to capital, asset quality, earnings, and liquidity. And, as the pandemic evolves, the NCUA will continue to adjust its supervision and examination program to address potential risks to the Share Insurance Fund and the broader system.

As more Americans receive the COVID-19 vaccine, the NCUA anticipates increased economic activity and job creation. Nonetheless, it will take time for the economy to heal completely. Although the unemployment rate has fallen sharply since last spring, the labor market recovery has been uneven. Lower-income households, which were hit harder by the recession than upper-income households, may not begin to feel the effects of the recovery for some time. For these households, high unemployment will likely continue to impede loan demand, especially for non-mortgage consumer loans, and the credit quality of loans already on the books could be affected.

As noted earlier, credit union shares and deposits surged last year, reflecting the boost to member income from economic stimulus payments as well as the economy-wide increase in personal savings. Shares likely got another substantial boost at the start of 2021, as many member households received two more rounds of federal relief payments provided under the Consolidated Appropriations Act and the American Rescue Plan Act. Even after these payments are absorbed, credit union shares could remain elevated as consumers avoid riskier investments or refrain from making purchases until the economy is on a stronger footing. This will have implications for credit union net worth ratios as well as the Share Insurance Fund's equity ratio.

Additionally, credit unions face a prolonged period of very low interest rates. Short-term interest rates are expected to remain low for the foreseeable future. Longer-term interest rates have increased recently and are expected to edge higher, but they will generally remain lower than pre-pandemic levels, suppressing already compressed net interest margins. It also poses risks for credit unions that rely primarily on investment income. In the year ahead, a credit union's ability to manage interest-rate risk will play a crucial role in financial performance.

## State of the Share Insurance Fund

Created by Congress in 1970, the Share Insurance Fund is backed by the full faith and credit of the United States and insures the deposits of more than 124.3 million members at federally insured credit unions up to at least $250,000. As of December 31, 2020, the Share Insurance Fund insured $1.47 trillion in member deposits.[2]

Under the Federal Credit Union Act, one of the NCUA Board's primary missions is to protect the safety and soundness of the credit union system. An essential part of this responsibility is for the Board to maintain a strong and healthy Share Insurance Fund, which promotes confidence in the system of cooperative credit.

The dramatic rise in insured shares throughout last year resulted in an equity ratio for the Share Insurance Fund of 1.26 percent at the end of 2020.[3] This figure is 4 basis points higher than at the end of the second quarter of 2020, but it also represents a decline of 9 basis points from the year-end 2019 level.

If the equity ratio falls below 1.20 percent, or the NCUA Board projects it to do so within six months, then the NCUA Board is required to establish and implement a restoration plan within 90 days that would increase the equity ratio to at least the statutory minimum of 1.20 percent before the end of the eight-year period beginning upon the implementation of the plan, and such other conditions as the Board determines to be appropriate.

The Share Insurance Fund's equity ratio has steadily declined since 2014, even with fewer credit union failures causing losses to it. The primary drivers of this trend are the steady growth in insured shares and reduced investment income resulting from a persistent low interest-rate environment. Based on the current interest rate environment, even with a return to modest insured share growth levels and relatively low credit union failure losses to the Fund, the agency expects the equity ratio to continue its downward trajectory. As a result, it seems likely that the

[2] https://www.ncua.gov/files/publications/analysis/quarterly-data-summary-2020-Q4.pdf
[3] See p. 114 of the *2020 NCUA Annual Report*

Board will need to adopt a restoration plan at some point absent a sizable change in these underlying fundamentals.

## Update on the NCUA's COVID-19 Response

Throughout the COVID-19 pandemic, the NCUA has focused on three priorities:

- Protecting the health and safety of NCUA staff and contractors, so the agency can continue to perform its mission;
- Assessing the impact of COVID-19 on credit union members and operations; and
- Analyzing how the pandemic will affect the future financial condition of credit unions and the Share Insurance Fund.

Agency examiners continue to work closely with credit unions to obtain documentation and complete examination procedures offsite, so credit unions can, in turn, focus on providing services to their members.

**Supervisory Priorities in 2021**
Recognizing the continued challenges credit unions face due to the pandemic, the NCUA updated its supervisory priorities in January 2021 to focus its examination activities on the areas that pose the highest risk to the credit union industry and the Share Insurance Fund. Some of the agency's supervisory priorities are reviews of credit unions' efforts to:

- Maintain sufficient loss reserves;
- Comply with the Bank Secrecy Act and anti-money laundering laws and regulations;
- Implement provisions in the CARES Act applicable to credit unions and the CARES Act provisions extended through the Consolidated Appropriations Act, including the suspension of the requirement to categorize certain eligible loan modifications as troubled debt restructurings;
- Comply with consumer financial protection laws and regulations;
- Monitor and control credit risk;
- Protect information systems and strengthen cybersecurity defenses;
- Transition from the use of LIBOR; and
- Manage for the potential liquidity risk due to the economic impact of the pandemic.

As the pandemic and its economic and financial disruptions evolve, the NCUA will continue to update its policies and procedures to enhance its supervision program and to provide necessary guidance to the industry.

Over the last year, the NCUA has also established priorities to focus examination and supervisory activities on credit unions that pose the greatest risk to the credit union system. Of highest priority are credit unions experiencing significant financial or operational problems. This includes credit unions that have asked for assistance and those the NCUA determines may need assistance based on their financial and operational conditions. NCUA examiners will continue working with those credit unions to identify what assistance, if any, is needed.

Additionally, the NCUA recognizes the need to ensure our nation's financial services system is not used for illicit or terrorist financing. The agency continues to work closely with its counterparts at bank regulatory agencies to adopt the significant changes occurring under the Anti-Money Laundering Act and Corporate Transparency Act of 2020.[4] The NCUA will also rely on the Treasury Department and the Financial Crimes Enforcement Network to consult and coordinate implementation of those laws, as appropriate.

**Regulatory Flexibility Measures**

Throughout 2020, the NCUA provided temporary and targeted regulatory flexibility to enable federally insured credit unions to manage their operational and financial risks while meeting their members' needs and adapting to social distancing measures within their communities.

In December 2020, the NCUA Board approved an extension of the effective date of certain regulatory requirements to help federally insured credit unions remain operational and provide appropriate liquidity management flexibility to address economic conditions caused by the pandemic. Specifically, the temporary final rule:

- Raised the maximum aggregate amount of loan participations that a federally insured credit union may purchase from a single originating lender to the greater of $5,000,000 or 200 percent of the credit union's net worth;
- Suspended limitations on the eligible obligations that a federal credit union may purchase and hold; and
- Suspended the required timeframes for the occupancy or disposition of properties not being used for federal credit union business or that have been abandoned.

Each of these temporary modifications were set to expire on December 31, 2020. Due to the continued effects of COVID-19 on credit unions and their members, the Board extended these measures through December 31, 2021.

In April 2021, the NCUA Board also renewed an interim final rule that temporarily modifies certain prudential requirements to help ensure federally insured credit unions remain operational and able to provide needed financial services during the COVID-19 pandemic. This interim final rule is substantively similar to the interim final rule approved by the Board in May 2020.

Specifically, the interim final rule makes two temporary changes to the NCUA's prompt corrective action regulations. The first change reduces the earnings retention requirement for federally insured credit unions classified as adequately capitalized. The second change permits an undercapitalized credit union to submit a streamlined net worth restoration plan if it becomes undercapitalized predominantly because of share growth. If a credit union becomes less than adequately capitalized for reasons other than share growth, it must still submit a net worth restoration plan under the current requirements in NCUA's regulations.

[4] Enacted into law as part of the National Defense Authorization Act for Fiscal Year 2021.

These temporary measures will remain in place until March 31, 2022. The interim final rule became effective upon publication in the *Federal Register*, and there is a 60-day public comment period currently underway.

**Central Liquidity Facility**

Following the statutory enhancements provided in the CARES Act and their extension in the Consolidated Appropriations Act, 2021, as well as related changes to the agency's regulations, the Central Liquidity Facility (CLF) experienced a significant increase in its membership and borrowing capacity.[5] I want to thank the Chairwoman, Ranking Member, and the Members of this Committee for supporting these enhancements last March, as well as their extension last December. And, as outlined later, I now respectfully request that these reforms be made permanent to better protect the credit union system from future liquidity events.

As of April 30, 2021, the number of regular members of the CLF, which consists of consumer credit unions, was 349, up from 283 members in April 2020. All 11 corporate credit unions became agent members in May 2020, meaning most of their member credit unions also have access to CLF liquidity. In total, 4,110 credit unions, or 81 percent of all federally insured credit unions, now have access to the CLF, either as a regular member or through their corporate credit union.

New memberships added $1.6 billion in additional total subscribed capital stock plus surplus to the CLF. Under the temporary authority granted by the CARES Act and later extended, the CLF can borrow sixteen times its total capital through the end of 2021. As of April 30, 2021, the facility's borrowing authority stood at $36.1 billion, an increase of $25.6 billion since April 2020.[6]

The NCUA encourages all credit unions to consider joining the CLF to bolster the system's access to emergency liquidity, should the need arise. And, there are several credit unions exploring joining the CLF, which would further increase capacity.

**Grants and Loans to Support Members and Underserved Communities**

Through its stewardship of the Community Development Revolving Loan Fund (CDRLF), the NCUA provides grants and loans to low-income-designated credit unions that use this funding to improve and expand services to members, build capacity, and stimulate local economic activity. Although relatively small in size, these grants make a big difference to low-income and minority credit unions working to provide more and better services to their members and communities.

In 2020, Congress appropriated $1.5 million for CDRLF technical grants. Congress has not provided an appropriation for the loan component since 2005. Instead, NCUA revolves loan funds to qualified credit unions to the extent possible. The urgent need grants the agency provides to low-income credit unions that experience unforeseen disruptions to their operations are funded from income generated by the CDRLF loan portfolio.

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[5] The Central Liquidity Facility 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.

[6] Central Liquidity Facility Monthly Reports

It should be noted the NCUA does not use appropriated funds to administer the CDRLF. Every penny of the appropriations goes to eligible credit unions and their member-owners.

Last year, the NCUA made the strategic decision to devote almost all its CDRLF efforts to help credit unions and their members meet the significant challenges posed by the COVID-19 pandemic. Overall, the NCUA received 432 technical assistance grant and loan requests for a total of $7.6 million. The agency's funding capacity allowed the NCUA to only award $3.7 million in technical assistance grants and loans to 165 credit unions.[7]

Additionally, the NCUA awarded 149 credit unions in 42 states and the District of Columbia more than $968,000 in urgent need grants. Of these credit unions, 144 received more than $930,000 in funding to assist with their operational needs resulting from the pandemic. Five credit unions received $37,000 in urgent needs grants to repair damage to their credit unions because of a natural disaster or another unexpected event.

Demand for CDRLF grants regularly exceeds supply. During the COVID-19 pandemic, the communities served by low-income credit unions and minority depository institutions (MDIs) are disproportionally affected by the pandemic's financial and economic disruptions. As such, I have previously requested that the Congress consider increasing CDRLF appropriations. I, therefore, appreciate Chairwoman Waters' recent letter to appropriators requesting an increase in CDRLF funding in 2022 to $10 million. With more funding, the agency could increase the number of credit unions receiving grants and increase the size of the grants it makes, deepening the program's impact in underserved communities.

**Working with Borrowers Affected by COVID-19**

Tragically, the COVID-19 pandemic has disproportionately affected low-income communities and communities of color. Besides being at a greater risk of contracting the virus, residents of underserved areas are more likely to experience pandemic-related economic and financial disruptions, like losing their jobs or getting evicted from their homes. Job losses, in turn, have made it increasingly difficult for individuals and families to pay for essential needs like food, shelter, and medicine.

Many minority-owned businesses have also been acutely affected by the suddenness and depth of the economic shock resulting from the lockdowns that were implemented to contain the spread of the virus. Rural and underserved communities, too, have been hard hit by COVID-19, and these are the areas that MDIs and low-income-designated credit unions predominately serve.

As cooperative, member-owned financial institutions that reinvest their earnings, many credit unions have a long history of assisting their member-owners in times of need. Throughout the COVID-19 pandemic, the NCUA has encouraged credit unions to work with members experiencing hardship by extending the terms of repayment, or otherwise restructuring their members' debt obligations.

[7] In 2020, the NCUA received 417 grant applications requesting $3.9 million in funding. The agency awarded approximately $1.6 million in technical assistance and minority depository institution mentoring grants to 156 credit unions. The NCUA also approved $2.25 million in loans to nine credit unions.

When prudent, credit unions may ease terms for new loans to members, as doing so may help consumer and business members deal with any impact on their financial well-being due to COVID-19. The NCUA has also instructed its examiners to refrain from criticizing a credit union's efforts to provide prudent relief for members, when conducted in a reasonable manner with proper controls and management oversight.

During the pandemic, millions of credit union members have also received government stimulus checks. Although lawmakers intended for consumers to spend this funding on necessities like food, shelter, utilities, and medical care, in some instances some financial institutions, including some credit unions, have instead used these stimulus payments to cover overdraft fees, outstanding debts, and other liabilities.

Financially stressed American consumers deserve better treatment. And, many federally insured credit unions have already voluntarily decided to protect their members' relief payments from collection, garnishment, and the right of offset. In doing so, these credit unions are demonstrating the cooperative philosophy at the heart of the credit union movement.

A small number, however, may choose a different course. Credit unions that withhold the stimulus money meant for daily living expenses for their members should fear the reputational risk they will face by failing to accommodate the needs of their members during tough times. To protect consumers and help families struggling during the pandemic downturn, I encourage Congress to continue working to protect the latest round of stimulus payments from garnishment and offset.

## Recent Rulemakings

I would now like to turn to several recent rulemakings and actions taken by the NCUA Board since last November. These matters include updating the credit union rating system, increasing the amount of capital within the system to absorb losses, and facilitating the ability of credit unions to work with borrowers experiencing financial trouble. Additional information about the Board's regulatory actions can be found on the NCUA's public website.[8]

**Adding Interest Rate Sensitivity or "S" to the CAMEL Rating System**
In January 2021, the NCUA Board unanimously approved a proposed rule that would add the "S" (Sensitivity to Market Risk) component to the existing CAMEL rating system, thus updating the rating system from CAMEL to CAMELS, and redefine the "L" (Liquidity Risk) component in the rating system. This proposal would enhance clarity and allow the NCUA, state supervisory authorities, and federally insured credit unions to better distinguish between liquidity risk and sensitivity to market risk. The amendment would also enhance consistency between the regulation of credit unions and other financial institutions.

The estimated implementation of this proposal is approximately one year, or as early as the first quarter of 2022. The comment period on this proposed rule closed on May 10, 2021.

[8] Information on the Board's actions can be found at https://www.ncua.gov/about/ncua-board/board-meetings-agendas-results

**Final Rules on Subordinated Debt**
In December 2020, the Board unanimously approved a final rule that amends various parts of the NCUA's regulations to permit low-income-designated credit unions, complex credit unions, and new credit unions to issue subordinated debt for purposes of regulatory capital treatment. One month later, the Board unanimously approved a final rule that amends the NCUA's corporate credit union regulation by making clear that corporate credit unions may purchase subordinated debt instruments issued by consumer credit unions and specifies the capital treatment of these instruments for corporate credit unions that purchase them.

Together, these two rules have the potential to increase capital within the credit union system and better protect the Share Insurance Fund — and taxpayers — from losses. Both rules become effective on January 1, 2022.

**Joint-Ownership Share Account Final Rule**
In February 2021, the Board unanimously approved a final rule amending the NCUA's regulation governing the requirements for a share account to be separately insured as a joint account. The final rule provides federally insured credit unions with an alternative method to satisfy the membership card or account signature card requirement.

The change is especially important given the challenges posed by COVID-19 and the resulting economic uncertainty. If the pandemic's economic fallout contributes to the failure of a federally insured credit union, the changes would facilitate the prompt payment of share insurance on joint accounts. The final rule went into effect on March 26, 2021.

**Proposed Rule on the Capitalization of Interest**
In November 2020, the Board unanimously approved a proposed rule that removes the prohibition on the capitalization of interest in connection with loan workouts and modifications.

For members experiencing financial hardship, a prudently underwritten and appropriately managed loan modification, consistent with safe-and-sound lending practices and consumer financial protection laws, is generally in the long-term best interest of both the member and the credit union. Such modifications may allow borrowers to remain in their homes, as well as help to minimize the costs of default and foreclosure for the credit union.

Specifically, the proposed rule would establish documentation requirements to ensure that the addition of unpaid interest to the principal balance of a mortgage loan does not hinder the member's ability to become current on the loan. The proposed change would apply to workouts of all types of member loans, including commercial and business loans. The proposal also contains important consumer financial protection guardrails, such as assessing a member's ability to repay, providing disclosures on the cost of the loan modification, ensuring that any workouts result in affordable and sustainable payments, and limiting the number of loan modifications.

The Board determined that the current prohibition on authorizing additional advances to finance unpaid interest might, in some cases, hamper a federally insured credit union's good-faith efforts to engage in loan workouts with members facing difficulty because of the economic disruption that the COVID-19 event has caused. Advancing interest may avert the need for alternative actions that would be more harmful to members.

The comment period on this proposal closed February 2, 2021. The agency is reviewing the comments received.

## Cybersecurity Efforts in Response to COVID-19

On the issue of cybersecurity, it is well-known that bad actors continue their attempts to undermine the very integrity of our interconnected financial system through fraud and cyberattacks. To compete, credit unions must be able to safely and securely use technology to deliver member services and to adopt financial innovations to ensure the industry's long-term success. However, each of us — the NCUA, state supervisory authorities, vendors, and credit unions — must work together to promote innovation with an emphasis on security and equity.

The pandemic has prompted a heightened cybersecurity stance for the agency and the industry, with an emphasis on credit union service continuity, remote workers' security and compliance, and flexibility regarding agency supervision and examination processes. The NCUA has seen increasing fraudulent activity, such as phishing, identity theft, and credential acquisition; ransomware; and cyber-enabled fraud methods within the credit union system. Emerging cyber-attacks are a persistent threat to the financial sector, and the likelihood of these threats adversely affecting credit unions and consumers is rising because of advances in financial technology and increases in the use of remote workforces and mobile technology for financial transactions.

The NCUA continues to promote cybersecurity best practices in credit unions, and reviews of credit union information systems and assurance programs remain a supervisory priority for the agency. Building upon its industry outreach efforts in 2020, the NCUA will continue to provide guidance and resources to assist credit unions with strengthening their cyber defenses throughout the year. As part of its 2021 CDRLF grant initiative, the agency is again funding cybersecurity grants.

The NCUA is also examining ways to strengthen cybersecurity reviews during regular examinations of credit unions. In 2020, the agency began piloting the Information Technology Risk Examination for Credit Unions (InTREx-CU). InTREx-CU harmonizes the IT and cybersecurity examination procedures shared by the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve System, and many state financial regulators, thereby generating a consistent approach across all community-based financial institutions. In 2021, the NCUA will continue to integrate this tool into our cybersecurity reviews.

## Diversity, Equity, and Inclusion

The NCUA has a long-standing commitment to diversity, equity, and inclusion, and these important values are reflected in the agency's policies and practices.

Numerous studies have demonstrated that organizations that prioritize the creation of a more diverse and inclusive workplace experience greater staff motivation, improved customer service, and higher employee retention, all of which lead to greater efficiencies and better financial performance. Thus, these principles are vital for the continued health and success of the credit union system.

**NCUA's Workforce Diversity**

With respect to its workforce, the NCUA continues to exceed the Civilian Labor Force in the Black/African American, Asian/Pacific Islander, and Multiracial groups. In 2020, 41.5 percent of new hires at the NCUA were people of color, and gender diversity among the agency's executives increased to 50.0 percent. Additionally, 15.4 percent and 4.2 percent of the NCUA's workforce identify as having disabilities and targeted disabilities, respectively. These figures exceed the federal employment goals established in Section 501 of the Rehabilitation Act of 1973.

The NCUA also works to advance the agency's mission and create a greater sense of belonging within its workforce through its seven employee resource groups. After establishing the program in 2018, the NCUA has 269 employees, or 23.4 percent, of the workforce, participating in one or more of these employee resource groups. This is more than twice the benchmark participation rate for successful programs.

Additionally, in May 2020, the agency launched its Culture, Diversity, and Inclusion Council. Comprised of 18 employees across the agency's business lines, in both supervisory and non-supervisory roles, the council's mission is to identify and advance a positive, high-performing organizational culture that will allow the NCUA to achieve its mission; support the agency's strategic goal of attracting, engaging, and retaining a highly skilled, diverse workforce by cultivating an inclusive environment; and assist and advise leadership on the implementation of strategic diversity and inclusion priorities.

In 2020, the council conducted an agency-wide culture and climate survey, which a majority (59 percent) of the NCUA's staff responded to. These survey results were combined with results from subsequent focus groups to assess employee perceptions of the NCUA's culture. The council is now analyzing the results and developing recommendations to address the issues identified in the survey.

Under any circumstances, these achievements would be commendable, but during a time of unprecedented change and uncertainty caused by the pandemic, they are a testament to the dedication of the NCUA's leadership and staff.

**Supplier Diversity**

The NCUA also understands the importance of developing and maintaining a base of suppliers and contractors where a diverse group of businesses is well-represented.

In 2020, 33.2 percent of the agency's reportable contracting dollars were awarded to minority- and women-owned businesses, a decrease of 9.8 percentage points from 43.0 percent in 2019.[9] Most of the decline was seen in technology purchasing, where the minority- and women-owned business contract spend was 33.3 percent in 2020 compared to 44.8 percent in 2019.

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[9] See p. 20, OMWI Report to Congress 2020

Despite this decline, 2020 was a relatively strong year for the NCUA's supplier diversity performance. And, the agency's performance continues to demonstrate the positive impact of intentional and consistent inclusion of proven, qualified, and responsive minority- and women-owned businesses in the competitive procurement process.

**Assessing Diversity Policies and Practices of Regulated Entities**
The NCUA's voluntary Credit Union Diversity Self-Assessment tool assists credit unions in implementing the diversity standards set forth in the *Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies*. Credit unions are encouraged to annually use and submit the self-assessment to the NCUA.

In 2020, 188 federally insured credit unions, 115 federal and 73 state-chartered, submitted self-assessments, an increase of 59.3 percent over 2019. Submitting credit unions varied in the number of employees and asset size. Of those credit unions submitting results, 104 had more than 100 employees, representing 15.1 percent of the credit unions in this category. The aggregate number of employees working at these credit unions represented 13.6 percent of employees at all federally insured credit unions. Asset sizes for the responding credit unions ranged from just above $1 million to more than $15 billion, with 142 of the 188 credit unions, or 75.5 percent, reporting $100 million or more in assets.

While the volume of self-assessment responses received has steadily increased, the NCUA recognizes the need for higher industry response rates. The NCUA's leadership team will, therefore, continue encouraging more credit unions to participate.

## Modernization of the NCUA's Examination Systems

Under the agency's Enterprise Solution Modernization Program, the NCUA is developing new technology to replace several existing systems that are at the end of their service lives.

The NCUA's current examination system, AIRES, is a custom-built, 25-year-old system based on outdated technology. Given the age of AIRES and the importance of an electronic examination system to the mission of the agency, priority was given to the development of its replacement, the Modern Examination and Risk Identification Tool, or MERIT. To successfully deploy this new system, it was also necessary to stand up the technology architecture, infrastructure, and security posture needed for a full modernization. MERIT and its related systems will be continually improved in the operations and maintenance phase of MERIT's lifecycle.

In addition to better and more robust financial analytics, MERIT provides numerous improvements over the legacy AIRES examination system, including better controlled access to examination data across the organization and greater efficiency in reporting.

Simultaneous to MERIT's development, the NCUA has been exploring the concept of virtual examinations of credit unions. 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.

The pandemic and off-site operational posture resulted in the implementation of virtual processes during 2020 to continue the agency's supervision of the credit union industry. This unplanned need provided an incubator and learning environment to identify effective and ineffective strategies for remote or virtual examinations. Based on the lessons learned, the agency is studying longer-term strategies to institutionalize the lessons learned during the pandemic for future changes within the virtual examination program. The full implementation of MERIT in the coming months will also facilitate the ability of the agency to conduct more of its supervisory efforts remotely in the future.

## Consumer Financial Protection

Equally vital to the members of credit unions is consumer financial protection and fair and equitable access to credit. To that end, the NCUA is working to strengthen its consumer financial protection program to ensure that all consumers receive the same level of protection, regardless of their financial provider of choice. The agency can do more to protect consumers' interests and ensure that the credit union system lives up to its commitment to serve members.

Specifically, the agency is developing a proposal to enhance consumer compliance examination procedures for the largest credit unions that are not primarily examined for consumer financial protection by the Consumer Financial Protection Bureau (CFPB), performing targeted consumer compliance examination procedures in every federal credit union exam, and developing consumer compliance training materials for examiners and credit unions. The agency is also placing an increased emphasis on fair lending compliance.

Regarding discrete consumer financial protection issues, the NCUA continues to focus on compliance with the forbearance provisions of the CARES Act and efforts to help consumers who are experiencing financial difficulties due to the pandemic. Whether it entails reworking an existing loan due to financial stress or delaying payments, the agency expects credit unions to work with their members as forbearance agreements and roll off and foreclosure moratoriums expire. Further, the agency has encouraged credit unions to be proactive and prepare for how they will handle the financial strains their members will experience as the pandemic's economic fallout continues.

The NCUA can also do more to improve the financial capability and personal finance knowledge of the member-owners of credit unions. Financial education plays a key role in helping consumers better understand how to save, earn, borrow, invest, and protect money wisely. Additionally, consumers who have a strong foundation in personal finance are essential to a healthy credit union system.

During the final months of 2020 and into the first quarter of 2021, the NCUA worked in partnership with other federal agencies to raise awareness of the importance of financial education. The agency cohosted webinars with the CFPB, Internal Revenue Service, and the FDIC on such topics as financial readiness for servicemembers, veterans and their families; the

Earned Income Tax Credit and Voluntary Income Tax Assistance program; and access to federally insured accounts at banks and credit unions for young people.

Going forward, the NCUA will continue to collaborate with other federal agencies and stakeholders to raise awareness of consumer financial protection laws and regulations and the importance of financial literacy. The agency's consumer website, MyCreditUnion.gov, is a resource that supports credit unions and their efforts to provide financial education to their members, and we are evaluating ways to improve this website.

## Economic Equity and Justice

Last year's nationwide Black Lives Matter demonstrations heightened public awareness of economic equity and justice. The NCUA and credit unions each have important roles to play in advancing this important goal.

Research conducted after the last economic downturn found that credit unions that leaned in and increased lending within underserved communities recovered more quickly than those that did not. Research has also shown that there are three primary ways to close the wealth gap. One is to open and regularly fund a retirement account; another way is to own a home; and the third way is to start a business.

Given the cooperative philosophy at the heart of the credit union movement, credit unions have a moral obligation to step up and help minority-owned businesses and communities recover and start anew in the months ahead. Through these efforts, credit unions can help ease the financial impact of COVID-19 and systemic racism on communities of color, and the result will be a more vibrant economic outcome for everyone in society.

The NCUA is working to address these issues as part of its Advancing Communities through Credit, Education, Stability and Support, or ACCESS, Initiative and through its CDRLF technical assistance grants and other efforts. As part of the ACCESS initiative, a working group at the NCUA is examining ways to modernize the chartering process to help ensure that groups that want to form new federal credit unions can do so in an efficient manner.

The NCUA will administer approximately $1.5 million in CDRLF grants this year to qualified low-income-designated credit unions, subject to the availability of funds. Grants will be awarded in three categories:

- Underserved Outreach (maximum award of $50,000);
- Minority Depository Institution Mentoring (maximum award of $25,000); and
- Digital Services and Cybersecurity (maximum award of $7,000).

The application period runs May 3 through June 26. These grants make a tremendous difference to small, low-income and minority credit unions working to provide more and better services to their members and communities or seeking to bolster their own capacity.

The NCUA continues its efforts to preserve and grow the number of MDI credit unions. By the end of 2020, 520 federally insured credit unions had self-certified as MDIs. These credit unions served 4.3 million members, held more than $51.1 billion in assets, and represented 10.2 percent of all federally insured credit unions.

The agency assists these vital institutions by:

- Offering technical assistance grants and training sessions;
- Facilitating mentor relationships between smaller MDI credit unions and larger MDI credit unions;
- Negotiating financial support to sustain MDIs;
- Delivering guidance to groups establishing new MDIs; and
- Approving new charter conversions and field-of-membership expansions to facilitate new opportunities for growth.

In 2021, the agency will continue to provide targeted training to MDIs on such topics as financial statement analysis and credit union board responsibilities. Additionally, the agency will host a series of forums with MDI credit unions beginning in the summer. These forums will take place virtually and focus on gaining a greater understanding of the evolving needs of MDI credit unions and how the agency can improve its MDI preservation program.

By enhancing support for small, low-income, and MDI credit unions, enforcing fair lending laws, and advancing initiatives to close the wealth gap, the NCUA can address the disparities created by centuries of systemic discrimination and exacerbated by the pandemic. The agency can also ensure that the cooperative nature of the credit union system lives up to its mission of meeting the credit and savings needs of consumers, including those of modest means.

## Legislative Requests

To ensure the NCUA has the tools it needs to respond to the ongoing pandemic and any future periods of economic and financial stress, I would like to close by briefly highlighting three additional areas where legislative action would aid the agency in fulfilling its statutory mission. In the coming weeks, the agency will provide the House Financial Services Committee with more detailed information on each of these requests.

**Vendor Authority**

The NCUA requests the Congress consider legislation to provide the agency examination and enforcement authority over third-party vendors, including credit union service organizations (CUSOs).

The NCUA was granted some authority in 1998 to deal with the Y2K changeover, but that authority unfortunately expired in 2002. Since then, the NCUA's Inspector General, the

Financial Stability Oversight Council, and the Government Accountability Office have all requested this authority be restored.[10]

Currently, the NCUA may only examine CUSOs and third-party vendors with their permission, and vendors, at times, decline these requests. Further, vendors can reject the NCUA's recommendations to implement appropriate corrective actions to mitigate identified risks. For example, in the past, several vendors refused to implement the NCUA's recommendations to improve network security and safeguard sensitive member information due to cost concerns. This stands in stark contrast to the authority of our counterparts on the Federal Financial Institutions Examination Council.

Increasingly, activities that are fundamental to the credit union mission, such as loan origination, lending services, Bank Secrecy Act/Anti-money laundering compliance, and financial management, are being outsourced to entities that are outside of NCUA's regulatory oversight. In addition, credit unions are increasingly using third-party vendors to provide technological services, including information security, and mobile and online banking. Member data are also being stored on vendors' servers. The pandemic, which has accelerated the industry's movement to digital services, has only increased credit union reliance on third-party vendors.

While there are many advantages to using these service providers, the concentration of credit union services within CUSOs and third-party vendors presents safety and soundness and compliance risk for the credit union industry. For example, the top five credit union core processor vendors provide services to approximately 87 percent of total credit union system assets. The top five CUSOs provide services to nearly 96 percent of total credit union system assets. A failure of even one of these vendors represents a significant potential risk to the Share Insurance Fund and the potential for losses from these organizations are not hypothetical. Between 2008 and 2015, CUSOs contributed to more than $300 million in losses to the Share Insurance Fund alone.[11]

The continued transfer of operations to CUSOs and other third parties diminishes the ability of NCUA to accurately assess all the risks present in the credit union system and determine if current CUSO or third-party vendor risk-mitigation strategies are adequate. This leaves thousands of credit unions, millions of credit union members, and billions of dollars in assets potentially exposed to unnecessary risks.

[10] Please see the following: U.S. Government Accountability Office, GGD-99-91 "Enhancing Oversight of Internet Banking" (July 1999) https://www.gao.gov/assets/ggd-99-91.pdf. Office of Inspector General, OIG-20-07, "Audit of the NCUA's Examination and Oversight Authority over Credit Union Service Organizations and Vendors" www.ncua.gov/files/audit-reports/oig-audit-cusos-vendors-2020.pdf. Annual Reports of the Financial Stability Oversight Council 2015, 2016, 2017, 2018, available at https://home.treasury.gov/policy-issues/financial-markets-financial-institutions-and-fiscal-service/financial-stability-oversight-council/studies-and-reports/annual-reports/fsoc-annual-reports-archive. See U.S. Government Accountability Office, GAO-04-91, "Financial Condition Has Improved, but Opportunities Exist to Enhance Oversight and Share Insurance Management" (October 2003) https://www.gao.gov/products/gao-04-91

[11] Office of Inspector General, OIG-20-07, "Audit of the NCUA's Examination and Oversight Authority over Credit Union Service Organizations and Vendors" www.ncua.gov/files/audit-reports/oig-audit-cusos-vendors-2020.pdf (See page 14)

As such, the NCUA requests the comparable authority as our FFIEC counterparts to examine third-party vendors. I look forward to working with the House Financial Services Committee on legislation to close this growing regulatory blind spot.

**National Credit Union Share Insurance Fund Improvements**
Three enduring lessons of the financial crisis in 2008 are the critical importance of well-funded deposit insurance systems to maintain financial stability during times of stress; the need for flexibility to properly prepare for and navigate through future crises; and the establishment of appropriate incentives for financial institutions to mitigate risk.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) made several changes to the Federal Deposit Insurance Act to increase the authority to manage the Deposit Insurance Fund. One provision increased the Deposit Insurance Fund's minimum reserve ratio from 1.15 percent to 1.35 percent.[12] Another provision removed the 1.50 percent upper limit on its designated reserve ratio and eliminated the requirement that dividends be provided from the Deposit Insurance Fund when the reserve ratio is between 1.35 percent and 1.50 percent.[13] The Dodd-Frank Act also granted discretion in determining whether to suspend or limit the declaration or payment of dividends.[14]

Congress did not make similar statutory changes to the Federal Credit Union Act's provisions governing the Share Insurance Fund following the financial crisis more than a decade ago. As a result, under current law, the NCUA does not have the appropriate flexibility necessary to manage the Share Insurance Fund in a manner consistent with the growing size and complexity of the credit union industry, as well as with broader national financial stability goals.

To address these concerns, the NCUA seeks changes to the statutory provisions contained in the Federal Credit Union Act to enable the NCUA Board to proactively manage the Share Insurance Fund. In particular, the agency requests the following legislative changes:

- Increase the Share Insurance Fund's capacity by removing the 1.50 percent statutory ceiling on its capitalization;
- Remove the limitation on assessing premiums when the equity ratio exceeds 1.30 percent, granting the NCUA Board discretion on the assessment of premiums; and
- Institute a risk-based premium system.

These recommended changes, if enacted, would allow the NCUA Board to build, over time, enough retained earnings capacity in the Share Insurance Fund to effectively manage a significant insurance loss without impairing credit unions' contributed capital deposits in the Share Insurance Fund. Moreover, these changes would generally bring the NCUA's statutory authority over the Share Insurance Fund more in line with the statutory authority over the operations of the Deposit Insurance Fund.

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[12] Pub. L. No. 111–203, 334(a), 124 Stat. 1376, 1539 (codified at 12 U.S.C. § 1817(b)(3)(B)); *see also* 75 FR 79286 (Dec. 20, 2010) available at https://www.fdic.gov/regulations/laws/federal/2010/10finaldec20.pdf.
[13] *Id.*
[14] *Id.*

**Central Liquidity Facility**
The CARES Act contained a provision that provided the NCUA with an important tool to ensure continued liquidity of the system as it responded to the COVID-19 pandemic. This provision, which was reauthorized in the Consolidated Appropriations Act, is set to expire on December 31, 2021. The NCUA respectfully requests that Congress make the enhancements to the NCUA's Central Liquidity Facility granted in the CARES Act permanent for the stability of the credit union system moving forward.

Before the CARES Act was enacted into law, the CLF had the authority to borrow provided its obligations did not exceed twelve times the subscribed capital stock and surplus of the CLF (that is, the sum of its retained earnings and capital stock). 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.

Second, the CARES Act temporarily relaxes the requirements on agent membership, making such membership more affordable for corporate credit unions. An agent member is no longer required to buy capital stock for all its member credit unions, it may buy CLF capital stock for a chosen subset of the credit unions it serves.

Third, the CARES Act changed the definition of "liquidity needs" to include the needs of any credit union, not only consumer credit unions. 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." 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.

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. However, it is important that these temporary enhancements to the CLF are made permanent.

We know from experience that any time there are economic contractions, we can expect credit unions' liquidity needs to rise. Those liquidity needs may spike after the current expiration date of these statutory changes, or they may increase during a future economic crisis. Permanence would provide regulatory certainty for federally insured credit unions during the current crisis and bolster the credit union system's ability to respond to future emergencies.

## Conclusion

In conclusion, the NCUA appreciates the continued support of the House Financial Services Committee for the credit union system and its members, as well as the goals, priorities, initiatives, and employees of the NCUA.

Unquestionably, 2020 was an unusual year in which the many participants within the credit union system rose to numerous challenges. In that regard, I would like to express my deep gratitude and appreciation to the NCUA's 1,141 employees and my fellow Board members, including former Chairman Rodney E. Hood, who led the agency throughout much of the crisis. The NCUA staff and Board are fundamental to the agency's effectiveness. None of us could have anticipated the extraordinary circumstances we found ourselves in this past year, yet the NCUA team has exhibited tremendous resilience in responding to the pandemic.

As we continue to smartly and safely navigate through the pandemic-induced economic crisis and plan for the future, the NCUA will stay focused on addressing the needs and best interests of credit union members, while also ensuring the safety and soundness of the credit unions and protecting the Share Insurance Fund from losses. By staying focused on these issues, we can together ensure that the cooperative philosophy at the heart of the credit union movement achieves its full potential and address long-standing issues of economic equity and justice.

I look forward to working with all of you in support of these endeavors. Thank you.

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STATEMENT OF

MICHAEL J. HSU

ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

May 19, 2021

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

***Introduction***

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, I am pleased to provide an update on the activities underway at the Office of the Comptroller of the Currency (OCC) to ensure that national banks and federal savings associations operate in a safe, sound, and fair manner.

Throughout the pandemic, the OCC has placed a priority on the health and safety of its workforce and taken steps to safeguard employees while maintaining their ability to ensure that the banks we supervise meet the objectives of our mission. The banks have played an important part in our nation's ongoing response to the COVID pandemic by providing essential banking services and needed capital and by extending credit to hundreds of millions of households and businesses.

Last week I was sworn in as Acting Comptroller of the Currency. It is a tremendous honor to work with the 3,500 dedicated professionals of the OCC. I appreciate the confidence Secretary Yellen has shown in me by appointing me to this important post. I am looking forward to building on the agency's long history and rich heritage.

I am a career public servant and a bank supervisor at my core. My experiences at the Securities and Exchange Commission, U.S. Department of the Treasury, International Monetary Fund, and the Board of Governors of the Federal Reserve System over the past 19 years have spanned periods of growth, crisis, reform, and recovery. I have seen firsthand the benefits that financial innovation and healthy competition can bring, as well as the harm that excessive risk taking, ineffective risk management, poor internal controls and lax compliance can inflict on families and businesses, the banking system, and the economy. I am proud to have worked alongside some of the smartest and most dedicated public servants in the world to repair and restore confidence in the financial system so that consumers, businesses, and communities can save, borrow, and participate in the economy.

Promoting fairness and inclusion in banking is a fundamental part of the OCC's mission. The events of the past year have compelled me and many others to consider whether we are achieving fairness across many aspects of society, including banking. I look forward to working with members of the committee, fellow regulators, community groups, banks, academics, and the staff of the OCC to ensure that the banking system works for *everybody*, especially those who are vulnerable, underserved, and unbanked.

My testimony today is focused on my priorities for the OCC and the review of key regulatory standards and pending actions that I immediately initiated upon taking office.

***Priorities***

As Acting Comptroller, I have a responsibility to address urgent problems and issues facing the OCC and federal banking system. I see four challenges requiring the agency's immediate attention: (1) guarding against complacency by banks, (2) reducing inequality in banking, (3) adapting to digitalization, and (4) acting on the risks that climate change presents to the financial system.

(1) Guarding Against Complacency by Banks

I believe the banking system, especially large banks, is at risk of becoming complacent.

Despite a once-in-a-lifetime pandemic, the banking system remains healthy. Key measures of financial strength – capital and liquidity ratios – are strong. Bank capital levels are well above where they were before the Great Recession, and bank liquidity is also substantially higher.

Banks are also profitable. Despite the extraordinary impacts of the pandemic on the economy, by year-end 2020, the banking system had largely recovered. Banks' average return on equity in the fourth quarter of 2020 slightly exceeded the average bank ROE in the fourth quarter of 2019 (11 percent versus 10.8 percent).

However, I am concerned that as the economy recovers and returns to normal, over-confidence leading to complacency is a risk. Indeed, the $10 billion in cumulative losses related to Archegos, a non-bank financial company, reminds us of the importance of sound risk management.

Many large banks have ambitious growth plans, a robust merger outlook, and a "risk on" posture evident from investor calls. When done prudently, growth can provide significant benefits to consumers, communities, investors, and the U.S. economy. When done in an unsafe, unsound, and unfair manner, however, excessive growth can cause significant damage. One of our most important tasks as bank supervisors is to identify, assess, and act before that is the case.

My experience has made me sensitive to certain signals. Capitulation is one. In a dynamic economy, there is a constantly evolving set of products, practices, and clients that banks avoid, or limit exposure to, based on their risk appetite. For instance, a year ago at the height of the pandemic, most large financial firms avoided crypto-related activities and limited their exposures to Special Purpose Acquisition Companies (SPACs).

Today things are different. In some cases, banks have done the work necessary, developed the risk management capabilities, and put in place the appropriate resources to engage prudently with these products, practices, and clients. In other cases, because of market demand and/or a fear of losing client share, banks have set aside their initial risk management concerns and engaged with more risk imprudently. Distinguishing between cases that are appropriate and those that are not, is a task for supervision (as distinct from regulation) and a critical component of guarding against complacency in the current environment.

Another critical task is ensuring that banks maintain robust financial positions, especially with regards to capital and allowances for loans and lease losses. The agency's *Semiannual Risk Perspective* report provides analysis and insights into these and other risks facing banks and federal savings associations.[1] The report shows that credit risk remains elevated and is transitioning as the economic downturn continues to affect some borrowers' ability to service their debts and as economic activity accelerates as regions of the nation emerge from the pandemic. Assistance programs and federal, state, and local stimulus programs have suppressed past-due levels. Strategic risks associated with banks' management of net interest margin compression and efforts to improve earnings are elevated. Banks attempting to improve earnings may be tempted to implement measures including cost cutting, increasing credit risk, or extending duration. Operational risk is elevated because of a complex operating environment and increasing cybersecurity threats. Compliance risk is elevated as banks' expedited efforts to implement assistance programs challenge established change management, product, and service risk management practices.

Complacency is not a binary state. It often starts with small tradeoffs. Take, for instance, how banks respond to earnings pressures. Despite very low funding costs from low rates, loan growth is flat to declining. The impact of CARES Act programs on the business of banks, particularly mid-sized and community banks, was profound. Commercial and industrial loans, driven by PPP lending, expanded 3.1 percent for 2020. However, absent the PPP, C&I lending would have shrunk 9.1 percent. With such compressed margins, banks of all sizes may be tempted to reach for yield, operate beyond their risk appetites, or compromise their sound risk management.

[1] See https://occ.gov/publications-and-resources/publications/semiannual-risk-perspective/index-semiannual-risk-perspective.html

In addition, the country's recent experience with the Solar Winds and Colonial Pipeline cyber-attacks underscores the need for banks to maintain and fortify a strong cybersecurity posture and risk management controls. The OCC is coordinating with the Federal Reserve and FDIC to conduct cybersecurity reviews at the largest banks, and recently issued a paper on Sound Practices to Strengthen Operational Resilience[2] and a Notice of Proposed Rulemaking (NPR) on Computer Security Incident Notification.[3] The OCC looks forward to receiving comments on the NPR and engaging with the industry to institute best practices in this area.

As supervisors, being vigilant and guarding against complacency will help ensure that the banking system remains safe, sound, and fair, and can support a strong economic recovery.

(2) Reducing Inequality in Banking

Reducing inequality must be a national priority. The events of the last two years have brought our history of financial inequality into sharp relief. Recent research by the Brookings Institute illustrates the stark economic inequality faced by communities of color. In the average U.S. metropolitan area, homes in neighborhoods where the share of the population is 50 percent Black are valued at roughly half the price as homes in neighborhoods with no Black residents, suggesting that the most important source of generation wealth building has been denied this segment of the population.[4]

The pandemic has had a disproportionate impact on minority households and businesses and threatens to further exacerbate financial disparities. The Federal Reserve's Survey of Household Economics and Decisionmaking, known as SHED, provides further evidence of the historical disparities experienced by communities and the impact the pandemic has had on the most vulnerable within our nation. The most recent report from that survey released in May showed the gap in financial well-being between White adults and Black and Hispanic adults grew by 4 percentage points since 2017 alone and more than a third of Black and Hispanic adults reported

[2] OCC News Release 2020-144. "Agencies Release Paper on Operational Resilience." October 30, 2020 (https://occ.gov/news-issuances/news-releases/2020/nr-ia-2020-144.html).

[3] OCC News Release 2020-175. "Agencies Propose Requirement for Computer Security Incident Notification." December 18, 2020 (https://www.occ.gov/news-issuances/news-releases/2020/nr-ia-2020-175.html).

[4] Andre Perry, Jonathan Rothwell, and David Harshbarger. "The Devaluation of Assets in Black Neighborhoods." Metropolitan Policy Program at Brookings. November 2018.

doing worse financially than prior to the pandemic.[5] Black and Hispanic households have been more likely to lose income and have trouble making rent or mortgage payments during the pandemic,[6] while minority-owned small businesses have been hit harder than white-owned small businesses.[7] The recovery threatens to leave these and rural communities even further behind.[8]

Banks can play an important role in preventing this and closing the wealth gap. Historically, many low-income individuals have been treated by banks as either credits to be avoided or credits to be exploited. The OCC's twin missions of ensuring equal access to financial services and fair treatment speak to both of these challenges.

To address this problem, the OCC must work to *strengthen* regulations implementing the Community Reinvestment Act (CRA). While the OCC's 2020 final rule took an important step in attempting to improve upon the framework put in place in 1995, I believe there is significant room for improvement. First, circumstances have changed because of the pandemic, and we should examine the extent to which its aftermath will have a disproportionate impact on minorities, rural communities, and vulnerable groups. Second, the public has provided helpful feedback on the Federal Reserve's advance notice of proposed rulemaking. Third, we have learned important lessons based on the partial implementation of the 2020 rule. I have asked staff to review the 2020 final rule with these considerations in mind. All options are under consideration, including rescinding or substantially revising the current rule and working with the Federal Reserve and FDIC on a joint proposal. Without prejudice to the outcome of the review, I am committed to following normal procedures and seeking public comment on any changes. The CRA is too important to do otherwise—all voices need to be heard and considered.

Second, we must be vigilant in examining and enforcing fair lending laws that promise fair

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[5] "Economic Well-Being of U.S. Households in 2020." Board of Governors of the Federal Reserve System. May 2021.

[6] Sharon Cornelissen and Alexander Hermann. "A Triple Pandemic? The Economic Impacts of COVID-19 Disproportionately Affect Black and Hispanic Households." Joint Center for Housing Studies. Harvard University. July 7, 2020.

[7] André Dua, Deepa Mahajan, Ingrid Millán, and Shelley Stewart. "COVID-19's effect on minority-owned small businesses in the United States." McKinsey. May 27, 2020.

[8] Emily Moss, Kriston McIntosh, Wendy Edelberg, and Kristen Broady. "The Black-white wealth gap left Black households more vulnerable." Brookings Institute. December 8 2020 (https://www.brookings.edu/blog/up-front/2020/12/08/the-black-white-wealth-gap-left-black-households-more-vulnerable/).

treatment and consumer protection and are intended to correct systemic bias of the past. The OCC will not hesitate to use the full range of tools under our supervisory authority to remediate deficiencies when we see them. When warranted, this may include assessing penalties and taking enforcement actions to hold banks accountable for violations of laws and regulations.

Third, we must call out racial, gender, and other biases and push for change where needed. For instance, the OCC has been monitoring increasing concerns about racial bias in appraisals, particularly in residential lending.[9] The OCC is engaged with stakeholders to raise awareness and facilitate improvements in the appraisal process, making sure banks have the valuation information and data they need to underwrite their loans and manage their risks, and that the process is fair, objective, and free from bias.

Finally, in addition to regulatory action and supervision, we have leveraged our status as a respected and knowledgeable federal agency to convene leaders and inspire action toward solving long-standing problems within our financial system. Such is the goal of Project REACh.

*Origin and Scope of Project REACh*

Last summer, in the midst of the nation's calls for racial and economic equality, the OCC conceived and launched the "Roundtable for Economic Access and Change" (known as Project REACh).[10] Project REACh brings together leaders of banking, civil rights, technology, and business organizations to identify and reduce specific barriers that prevent underserved and minority communities from full, equal, and fair participation in the nation's economy. Project REACh convenes those with the ability to help reduce inherent and structural obstacles so underserved populations have the same opportunities to succeed and benefit from the nation's financial system as others. The OCC has dedicated staff supporting the project.

Shortly after launch, the participants of Project REACh identified several key barriers to financial inclusion and equity for underserved populations, including lack of usable credit scores, low rates of homeownership, and poor access to capital for minority-owned and small businesses.

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[9] "Black Homeowners Face Discrimination in Appraisals." *New York Times*. August 27, 2020 (https://www.nytimes.com/2020/08/25/realestate/blacks-minorities-appraisals-discrimination.html).

[10] "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).

Four national workstreams, described below, were formed to address those.

*Inclusion for credit invisibles*: Forty-five million Americans—disproportionately poor and minority—lack a credit score and cannot obtain mortgages, credit cards, or other lending products. Yet many people in this segment pay rent, utilities, and other recurring financial obligations. Project REACh participants are evaluating models that use alternative data sources, including rent payments, utility bill payments, and other direct debit authorizations to demonstrate on-time payment history and boost the measurable creditworthiness of many Americans. Some of the banks engaged in this workstream are working with technology firms to develop a pilot program that would evaluate data and boost the creditworthiness of gig economy workers. These can help tear down a major barrier to economic access for millions of consumers and minority entrepreneurs, who currently rely on their personal credit to secure business loans. Today, some large banks are in the process of issuing credit cards and other consumer lending products to individuals with no credit score. Other progress in this area was reported in the press last week regarding a collaborative effort to test the use of alternative data and underwriting to provide broader responsible access to credit for previously underserved people.[11]

*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 communities, but face challenges with accessing capital, adopting new technology, and modernizing their infrastructures. Project REACh recognizes opportunities for partnerships that deliver sustained financial assistance to help MDIs remain a vibrant part of the economic landscape. The OCC has expanded relationships between larger banks and MDIs through capital investments dedicated to improving the technological infrastructure of MDIs so they can offer the same benefits to their customers like remote capture and faster electronic payment platforms.

Last fall, we developed a pledge for larger banks to support MDIs.[12] To date, 22 banks have signed the pledge to provide dedicated technical assistance to help with talent development for MDI staff, as well as diversification of product offerings, and have committed nearly half a

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[11] Peter Rudegeair and AnnaMaria Andriotis. "JPMorgan, Others Plan to Issue Credit Cards to People With No Credit Scores." *Wall Street Journal*. May 13, 2021 (https://www.wsj.com/articles/jpmorgan-others-plan-to-issue-credit-cards-to-people-with-no-credit-scores-11620898206).

[12] See OCC Project REACh Pledge to Strengthen Minority Depository Institutions. (https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-166a.pdf).

billion dollars in investments to MDIs. Most recently, we facilitated a meeting between the National Bankers Association, which represents minority financial institutions, and three of the largest service providers to mid-sized and community banks to assess how they can build better business relationships with MDIs and offer more affordable, innovative solutions to them.

*Increasing homeownership and the inventory of affordable housing*: Homeownership is one of the primary ways that families build wealth. Notably, since the Great Recession, the homeownership gap between Blacks and whites has *grown* to its highest level in 50 years.[13] One of the biggest barriers to homeownership for minority borrowers is that they do not have enough saved for a down payment. Working with civil rights and community-based groups, several participating banks have developed or expanded down payment assistance programs for minority and underserved homebuyers. These programs work in conjunction with community groups with counselors approved by the U.S. Department of Housing and Urban Development to provide consumers educational support for eligibility in these programs.

To increase the inventory of affordable housing, particularly in densely populated markets, Project REACh participants are exploring converting bank-owned housing inventories into affordable homes through low-cost transfer and renovation loans. This has included proposals to repurpose underutilized and surplus commercial real estate into mixed-use facilities that would include residential property and provide additional homebuying opportunities.

*Expanding access to capital for minority-owned and small businesses*: Project REACh participants also are engaged in evaluating models and strategies that facilitate loan participations and consortium lending to minority-owned and small businesses. The effort involves developing a consortium model whereby MDIs, community development financial institutions (CDFIs), and larger banks collaborate to support agricultural businesses and emerging commercial enterprises and industries in rural and native communities, such as clean energy and broadband.

To support small businesses more generally, other Project REACh participants are identifying the challenges of collateral requirements and transitioning entrepreneurs from over-utilization of consumer credit towards establishing a commercial credit profile and small business identity that meets the qualifications for small business trade lines. Participants also are currently developing a comprehensive guide for entrepreneurs to point them to the resources they need along

[13] Urban Institute, "Breaking Down the Black-White Homeownership Gap" Feb. 21, 2020.

the business development continuum.

Finally, a few participating Project REACh banks have created and offered virtual procurement showcases for minority-owned enterprises and entrepreneurs from underserved communities to build better business relationships and provide opportunities for growth and expansion.

While the four workstreams noted above are national in scope, the path to economic inclusion is often local. Needs differ across communities and markets. That is why we have created area-specific demonstrations of Project REACh where local stakeholders directly voice what their needs are and how to overcome their specific and unique economic barriers. Regional programs and efforts a have expanded to Los Angeles, and several other cities are under consideration as areas of focus.

*OCC's Commitment to Diversity and Inclusion*[14]

As an agency, we also need to do our part to reduce inequality and improve our own diversity, equity, and inclusion. As Acting Comptroller, I am committed to continuing to promote these efforts and ensure that they continue to be areas of focus for my Executive Committee.

The OCC engages in comprehensive hiring, recruitment, and employee retention strategies to support efforts to expand agency diversity. We also provide a wide range of formal and informal career development opportunities to provide leadership skills to our employees, which are crucial for career development. Additionally, the OCC has eight employee network groups,[15] each of which serve as a collective voice in communicating workplace concerns and providing input to management around diversity and inclusion programs within the OCC. These have proven to be a valuable means to attract and retain employees from diverse backgrounds and create an inclusive work environment for all employees.

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[14] Testimony of OMWI Director Joyce Byrd Cofield before the House Financial Services Subcommittee on Diversity and Inclusion, September 8, 2020 for a detailed explanation of our diversity and inclusion programs (https://www.occ.gov/news-issuances/congressional-testimony/2020/ct-occ-2020-118-written.pdf).

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

Such efforts have made some progress. Over the past 10 years, the OCC's total minority workforce has increased, and both manager and senior-level manager positions held by minority and female populations also have increased.[16] While the trend is positive and strides have been made, more needs to be done.

For the third consecutive year, the OCC will host its High School Scholars Internship Program (HSSIP) this summer, a six-week paid internship for nearly 100 minority students from public and charter high schools in the District of Columbia. This program provides an opportunity for students to explore a variety of career paths at the OCC, gain an understanding of the financial services industry, and engage in enrichment activities on financial literacy and leadership fundamentals. In addition to our HSSIP program, the OCC has provided minority college students paid internship opportunities for more than a decade through its National Diversity Internship Program.

(3) Adapting to Digitalization

The business of banking is changing rapidly, driven by three related trends: (1) the mass adoption of digital technology, (2) the rise of payments, and (3) technological innovations developed outside of the banking system.

For me, it is hard not to feel some déjà vu. In the 1990s and 2000s, "disintermediation" was the watchword. Securities firms and capital markets were disintermediating bank lending and the innovation was focused on financial engineering (credit default swaps, collateralized debt obligations, etc.). While this led to greater efficiency in the allocation of credit from savers to borrowers, it also gave rise to a large and less regulated shadow banking system, which eventually collapsed and contributed to the Great Recession.

Today, banks are again being disintermediated but in a different way. Instead of securities firms and capital markets, it is fintechs and technology platforms. Instead of lending, it is payments processing. Instead of financial engineering, it is application programming interfaces, machine learning, and distributed ledgers.

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[16] The OCC's minority population has increased from 30 to 36 percent. Manager positions held by minority and female populations increased from 21 to 28 percent and 37 to 39 percent respectively. Senior level manager positions held by minority and female employees increased from 20 to 25 percent and 27 to 30 percent respectively.

I believe these trends cannot be stopped. They bring great promise, but also risks. Banks and the regulatory community must adapt to them.

My primary concern is that the regulatory community is taking a fragmented agency-by-agency approach to these trends, just as it did in the 1990s and 2000s. To the extent there is interagency coordination, it tends to be tactical, to deal with a pressing issue, such as Facebook's Diem. The key strategic question which the regulatory community must answer collectively is: Where should we set the regulatory perimeter? To my knowledge, there is not a shared understanding of the answer to that question and no overarching strategy to achieve it.

At the OCC, the focus has been on encouraging responsible innovation. For instance, we created an Office of Innovation, updated the framework for chartering national banks and trust companies, and interpreted crypto custody services as part of the business of banking. I have asked staff to review these actions.

My broader concern is that these initiatives were not done in full coordination with all stakeholders. Nor do they appear to have been part of a broader strategy related to the regulatory perimeter. I believe addressing both of these tasks should be a priority.

Finally, I would like to share my preliminary perspective on licensing and charters. Notwithstanding the strong oversight and enhanced provisions the OCC requires, some are concerned that providing charters to fintechs will convey the benefits of banking without its responsibilities. Others are concerned that refusing to charter fintechs will encourage growth of another shadow banking system outside the reach of regulators. I share both of these concerns. Denying a charter will not make the problem go away, just as granting a charter will not automatically make a fintech safe, sound, and fair. I will expect any fintechs that the OCC charters to address the financial needs of consumers and businesses in a fair and equitable manner and support the important goal of promoting the availability of credit. Recognizing the OCC's unique authority to grant charters, we must find a way to consider how fintechs and payments platforms fit into the banking system, and we must do it in coordination with the FDIC, Federal Reserve, and the states.

(4) Acting on the Risks that Climate Change Presents to the Financial System

As Secretary Yellen has noted, climate change poses an existential risk. Multiple government agencies are charged with addressing the environmental and social problems that climate change presents. Our focus at the OCC is on understanding how climate change may impact the safety and soundness of the institutions we supervise.

For supervisors, the problem statement is straightforward: banks are exposed to physical and transition risks. Physical risks include the increased frequency, severity, and volatility of extreme weather and the associated impact on the value of financial assets and borrowers' creditworthiness. Transition risks relate to adjustments to a low-carbon economy and include associated policy changes from Congress and other authorities, technology changes, and litigation.

The actions that need to be taken are less simple, however. Banks and supervisors are still developing methods for identifying, measuring, and managing physical and transition risks. Based on my observations, this will not be an easy or swift task.

Given this, I believe the OCC can help most if it adopts a two-pronged approach. First, we must engage with and learn from others. The OCC already participates in the Basel Committee on Banking Supervision's Task Force on Climate-Related Financial Risks. The group has taken stock of member initiatives on climate-related financial risks, cataloguing them for member organizations to benefit from one another's experience. Building on this, I have asked OCC staff to explore joining the Network for Greening the Financial System (NGFS), a group of central banks and supervisors from across the globe interested in addressing climate change through the sharing of best practices and development of climate and environment-related risk management. The more perspectives and experiences we can leverage, the better.

Second, we must support the development and adoption of effective climate risk management practices at banks. The OCC's approach to date has been to monitor climate change-related developments at banks. I have asked staff to build on this approach and develop options for taking more concrete actions. These could include hosting or co-hosting a conference focused on climate change risk management practices at financial institutions, performing a thorough review of our existing policies, and evaluating a range of bank practices relative to identification and measurement, and risk management approaches. Managing the risks of climate change will require a collective effort and we will seek opportunities to hear from all stakeholders of our federal banking system.

At the most recent Financial Stability Oversight Council meeting, Secretary Yellen called out climate change as a financial stability risk. The OCC is committed to collaborating with FSOC and other FSOC members, as well as market participants and international standard-setting bodies to inform our approach to the financial stability implications of climate change.

As Acting Comptroller, I will work to ensure the agency is proactive in this space and acts with the sense of urgency.

***Reviews***

Shortly after I started, I requested a review of key regulatory standards and matters pending before the agency. Those items include the 2020 Community Reinvestment Act (CRA) final rule and associated NPR related to performance benchmarks, interpretative letters and guidance regarding cryptocurrencies and digital assets, and pending licensing decisions. For each, the review is considering a full range of internal and external views, the impact of changed circumstances, and a range of alternatives.

With regards to the CRA, we recently issued a Bulletin and letters to banks pausing the mandatory data collection associated with the rule and indicating that the final rule is under reconsideration. Before making any changes to the CRA final rule, we plan to seek public input, consistent with the requirements of the Administrative Procedure Act. As noted, all options are under consideration.

The Fair Access rule is not part of the review. The agency declined to enact the rule before I became Acting Comptroller, and I have no intention of revisiting that decision.

The disposition of other standards and matters will depend on the facts and circumstances of each case. In all stages of the review, I will keep an open mind. I expect the review to conclude this summer when I will evaluate findings and announce next steps.

***Conclusion***

I am committed to ensuring that OCC-supervised banks operate in a safe and sound manner, meet the credit needs of their communities, treat all customers fairly, and comply with laws and regulations. As we emerge from the pandemic, I will do my part to ensure that the national banking system continues to serve as a source of strength to the U.S. economy, extends opportunities to underserved populations, and meets the evolving banking needs of the consumers, businesses, and communities it serves.

**STATEMENT OF**

**JELENA MCWILLIAMS**

**CHAIRMAN**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**on**

**OVERSIGHT OF PRUDENTIAL REGULATORS: ENSURING THE SAFETY, SOUNDNESS, DIVERSITY, AND ACCOUNTABILITY OF DEPOSITORY INSTITUTIONS**

**before the**

**COMMITTEE ON FINANCIAL SERVICES**

**U.S. HOUSE OF REPRESENTATIVES**

**May 19, 2021**

Chairwoman Waters, Ranking Member McHenry, and members of the Committee, thank you for the opportunity to testify today.

Since I last testified before this Committee six months ago, an additional two quarters of financial reporting from depository institutions shows that the banking system continues to be a source of strength for Americans and their financial needs.

Our nation's banks have withstood the initial economic and financial market volatility of 2020, reflecting their strength going into the pandemic – including strong asset quality and robust capital and liquidity positions. After weathering the initial shock, banks became instrumental in supporting individuals and businesses through lending and other financial intermediation and by distributing financial support provided by the federal government. In contrast to the high number of bank failures during the last financial crisis,[1] only three banks failed during the pandemic, and none were due to the pandemic or the ensuing economic stress.

Today, I will provide an update on six areas of focus for the FDIC:

- The state of the banking system and the return to the "new normal;"
- Our continued response to economic risks related to the pandemic;
- Resolution readiness;
- The supervisory process and regulatory actions;
- Financial inclusion; and
- Fostering innovation and American competitiveness.

[1] *See* Chapter 5: Deposit Insurance: Fund Management and Risk-Based Deposit Insurance Assessments, *in* CRISIS AND RESPONSE: AN FDIC HISTORY, 2008–2013, available at https://www.fdic.gov/bank/historical/crisis/.

## I. State of the Banking System and the Return to the "New Normal"

### A. *State of the Banking System*

Banking sector income for 2020 declined from its 2019 level, primarily due to higher provision expenses resulting from both the implementation of the Current Expected Credit Losses accounting methodology (CECL) by large banks and economic uncertainty associated with the pandemic. Despite this overall decline, fourth quarter net income rose, primarily due to higher noninterest income and lower provision expenses for credit losses, a reflection of both economic improvement and a more optimistic economic outlook. Net interest margin was unchanged from the record low level reached last quarter. Banks also reported modest declines in asset quality and loan volume.[2] The FDIC is in the process of analyzing call report data for the first quarter of 2021 that appears generally consistent with the fourth quarter of 2020. The FDIC is scheduled to release that data on May 26.

Despite the challenges of the pandemic, banks increased their capital levels in 2020. Total bank equity rose by 5.4 percent to $2.2 trillion. At year-end 2020, capital ratios remained strong with average core (or leverage) capital at 8.81 percent, average common equity tier one capital at 13.87 percent, and average total risk-based capital at 15.48 percent.[3]

When I last appeared before the Committee, I reported that the banking system had accommodated a sharp increase in customer demand for deposits that far exceeded any deposit growth the FDIC had seen in the past.[4] Deposit growth accelerated in the fourth quarter, reflecting persistently high savings rates and lower spending.[5] The deposit trend in the first quarter of this year appears generally consistent with last year's deposit growth, due primarily to continued fiscal support for the economy.

Sector consolidation slowed modestly in 2020. The net rate of consolidation for the banking sector in 2020 was 3.4 percent, the lowest rate since 2008. A slower rate of mergers, very few failures, and a low rate of voluntary closures contributed to the overall trend.

Banks of all sizes have continued to support their customers and communities throughout the pandemic, including by continuing to originate the overwhelming majority of approximately $800 billion in Small Business Administration-guaranteed Paycheck Protection Program (PPP) loans.[6] While total loan and lease balances declined for the banking sector in the fourth quarter,

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[2] *See* FDIC, Quarterly Banking Profile, Fourth Quarter 2020, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2020dec/qbp.pdf#page=1.

[3] *See id.* at 5-6.

[4] *See* FDIC, Quarterly Banking Profile, Second Quarter 2020, available at https://www.fdic.gov/analysis/quarterly-banking-profile/qbp/2020jun/.

[5] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[6] *See* SBA, Paycheck Protection Program (PPP) Report Approvals through 04/18/2021, available at https://www.sba.gov/sites/default/files/2021-04/PPP_Report_Public_210418-508.pdf.

primarily as a result of PPP loan forgiveness, loans increased over the full year 2020 by approximately 3.3 percent.[7]

The low interest rate environment coupled with economic uncertainties will continue to challenge the banking sector, placing downward pressure on revenue and the net interest margin. However, as noted above, the banking sector maintains strong capital and liquidity levels, which can mitigate potential future losses.

**B. *Return to the "New Normal"***

With the rollout of the COVID-19 vaccination program throughout the United States, the reopening of the economy, and the physical return to office for businesses throughout the country, there is guarded optimism that things will return to normal, whatever our "new normal" may look like. Though we continue to be encouraged by the state of the banking sector, uncertainty remains, including in areas that have been directly impacted by the pandemic and the related economic shutdowns. Below are several areas the FDIC is monitoring.

Commercial Real Estate

While commercial real estate (CRE) noncurrent loan levels remain manageable and well below previous crisis levels, there is uncertainty in the recovery of the CRE market given long-term leases and other potential lagging changes. In particular, pandemic-related changes in business travel, shopping, and work-from-home practices could challenge the lodging, retail, and downtown office market if those practices become permanent.[8]

Agricultural Lending

The pandemic initially looked to pose challenges to U.S. farmers. However, government assistance, a rebound in commodity prices in the second half of 2020, and a resurgence in export demand combined to improve agricultural conditions for borrowers and lenders. Furthermore, strong farmland equity has enabled farmers to restructure loans to manage operating losses and replenish working capital. Despite improving agricultural market fundamentals, net farm income is forecast to decrease in 2021 from 2020 levels because of lower direct government farm payments.[9]

Consumer Lending

In light of the pandemic, consumer borrowing declined in 2020 compared to 2019.[10] Business closures, higher levels of unemployment, changed consumer behavior resulting from

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[7] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[8] *See* FDIC, 2021 Risk Review (May 10, 2021), at 26-28, available at https://www.fdic.gov/analysis/risk-review/2021-risk-review/2021-risk-review-full.pdf.

[9] *See id*. at 4; U.S. Department of Agriculture, February 2021 Farm Income Forecast (Feb. 5, 2021), available at https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farm-income-forecast/.

[10] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

the pandemic, and higher income levels resulting from fiscal stimulus all contributed to lower levels of consumer borrowing.[11] Likewise, a number of banks tightened underwriting standards due to repayment concerns and risks of default.[12] At the same time, banks are reporting lower credit card balances and greater repayment of existing balances on those cards.[13] In contrast with the experience of the 2008 financial crisis, mortgage delinquencies in bank portfolios have remained relatively low and the underlying fundamentals of the housing market, such as homeowner equity and housing supply relative to demand, are strong.[14]

Technology Investments

The rapid transformation of the last year has amplified how critical technology is to empowering people's lives amidst a global pandemic. Innovation will continue to play a vital role for banks as they seek to meet consumer expectations for access to financial services and to improve the resilience of their operations. The pandemic has accelerated banks' adoption of digital banking and other new technologies. These advances have the potential to bring more people into the banking system, to provide access to new products and services, and to lower the cost of credit. As the FDIC works to foster these investments, we must also be mindful of the challenges that confront our institutions, particularly community banks that face budget, personnel, and competitive challenges to innovation, as well as growing cybersecurity risks.

Cybersecurity

Banks must also take steps to manage the risk that accompanies new technologies, to protect the sensitive information in their systems, and to ensure resilience in the face of attacks from those that might seek to disrupt bank operations. As the FDIC noted in January 2020, "disruptive and destructive attacks against financial institutions have increased in frequency and severity."[15] The pandemic and the related shift to doing an increasing amount of economic activity online have made increased vigilance in the area of cybersecurity all the more important. Technology can also enhance resilience in the face of security challenges, such as cyberattacks, in addition to operational challenges such as the pandemic.

Climate

The FDIC expects financial institutions to consider and appropriately address potential climate risks that could arise in their operating environment. This includes physical risks

[11] *See* 2021 Risk Review, *supra* note 8.

[12] *See id.*; Board of Governors of the Federal Reserve System, Senior Loan Officer Opinion Survey on Bank Lending Practices (July and October 2020), available at https://www.federalreserve.gov/data/sloos.htm.

[13] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2; 2021 Risk Review, *supra* note 8.

[14] *See* 2021 Risk Review, *supra* note 8; *see also* CoreLogic, Homeowner Equity Insights Report, Fourth Quarter 2020.

[15] *See* FDIC, FIL-03-2020, Heightened Cybersecurity Risk Considerations (Jan. 16, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20003.html.

associated with extreme weather events, such as hurricanes, floods, storms, tornadoes, droughts, and fires.

We also expect institutions to mitigate the risks associated with adverse climate or weather-related events that are common to specific locations or particular areas of the country. Such activities can include ensuring the institution and its borrowers have appropriate insurance coverage, adjusting borrowers' cash flow estimates based on reduced agricultural yields or adverse business conditions, and complying with applicable rules, regulations, and building codes.

The FDIC will continue to monitor the impact of climate and other emerging risks on the financial sector. FDIC economists and financial analysts conduct internal analysis of a range of factors that affect economic and banking conditions, including the potential implications of changing environmental conditions. Several FDIC Regional Risk Committees include environmental factors in their regular analysis, such as drought in the western states.

The FDIC will continue to engage with other regulatory bodies, domestic and international, on how best to address such risks, and looks forward to contributing to interagency work in this area.

## II. The FDIC's Continued Response to the Economic Risks Related to the Pandemic

Beginning in March of last year, the FDIC undertook a broad array of swift actions to maintain stability and public confidence in the nation's financial system. These actions focused on providing necessary flexibility to both banks and their customers – particularly the most heavily affected individuals and businesses – while maintaining the safety and soundness of the banking system. Throughout this period, the FDIC's supervisory activities and other essential functions have continued.

### A. *Encouraging Banks to Assist Affected Customers and Communities*

In mid-March of last year, we issued a statement to encourage banks to work with all borrowers, especially borrowers from sectors particularly vulnerable to the existing economic volatility, including airlines; energy companies; travel, tourism, and shipping companies; small businesses; and independent contractors that are reliant on affected industries.[16]

Notably, we made clear that prudent modifications to the terms on existing loans for affected customers of FDIC-supervised banks would not be subject to examiner criticism. We also noted that the FDIC would work with affected financial institutions to reduce burdens when scheduling examinations.

Shortly thereafter, we worked with the Financial Accounting Standards Board (FASB) to confirm that short-term loan 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

[16] *See* FDIC, FIL-17-2020, Regulatory Relief: Working with Customers Affected by the Coronavirus (Mar. 13, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20017.html.

restructurings (TDRs).[17] This clarification was critical to ensuring banks would be able to modify loans to borrowers impacted by the pandemic and lockdowns. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) subsequently expanded TDR relief to a broader set of loan modifications, and this relief was extended for another year in December.

In June, the FDIC and our fellow federal and state banking regulators issued examiner guidance that outlined principles for how examiners would supervise banks in light of the ongoing impact of the pandemic.[18] Notably, the guidance stated that examiners would continue to consider the unique, evolving, and potentially long-term nature of the issues confronting institutions and exercise appropriate flexibility in their supervisory response. We also made clear that actions taken in good faith reliance on statements issued by the agencies would not be subject to criticism or other supervisory action down the road, and we still stand by that.

### B. *Providing Flexibility for Banks*

To increase the capacity of banks to meet customer needs, we worked closely with the other federal agencies to make targeted regulatory changes to facilitate lending and other financial intermediation, including as mandated by the CARES Act.

Soon after the onset of the pandemic, we encouraged institutions to use their capital and liquidity buffers to support customers in a safe and sound manner.[19] The FDIC, Federal Reserve, and Office of the Comptroller of the Currency (OCC) issued an interim final rule that gave institutions implementing CECL in 2020 the option to delay for two years an estimate of its effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period.[20]

The FDIC also took a series of other actions to allow institutions to extend funds expeditiously to creditworthy households in light of the strains in connection with COVID-19, often in conjunction with our fellow regulators. For example, we temporarily reduced the

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[17] *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; FDIC, FIL-22-2020, Inactive: Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus (March 22, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20022.html. This March 22 statement was issued prior to the enactment of the CARES Act and was moved to inactive status following issuance of the Apri17 statement.

[18] *See* FDIC, FIL-64-2020, Interagency Examiner Guidance for Assessing Safety and Soundness Considering the Effect of the COVID-19 Pandemic on Financial Institutions (June 23, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20064.html.

[19] *See* FDIC, Federal Banking Agencies Provide Banks Additional Flexibility to Support Households and Businesses (Mar. 17, 2020), available at https://www.fdic.gov/news/news/press/2020/pr20030.html.

[20] *See* Regulatory Capital Rule: Revised Transition of the Current Expected Credit Losses Methodology for Allowances, 85 Fed. Reg. 17723 (Mar. 31, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-06770.pdf.

community bank leverage ratio to 8 percent,[21] permitted institutions to defer obtaining an appraisal or evaluation for up to 120 days,[22] provided a 45-day grace period for submitting annual audit reports,[23] and – to address the dramatic increases in banking assets caused by the fiscal and monetary responses to the pandemic – allowed community banks to use their end-of-2019 asset size for determining applicability of several regulations through the end of 2021.[24]

Taken together, these actions increased flexibility for these institutions to comply with regulatory obligations as they worked to meet customer needs.

### C. *Fostering Small Business Lending*

The FDIC also took a number of steps to facilitate the ability of banks to make loans to small businesses under the PPP. Overall, the PPP highlighted the vital role of banks in supporting small businesses. We saw that among the banks participating in the PPP, community banks in particular had an outsized impact on their customers and communities.[25]

Among other things, the FDIC established an FAQ resource for bankers[26] and issued a Financial Institution Letter for banks with important information on the PPP, including links to the SBA and U.S. Department of Treasury's webpages regarding the program.[27] The FDIC and the other bank regulatory agencies also issued interim final rules that allowed banking organizations to neutralize the regulatory capital effects[28] and the Liquidity Coverage Ratio

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[21] *See* Regulatory Capital Rule: Temporary Changes to the Community Bank Leverage Ratio Framework, 85 Fed. Reg. 22924 (Apr. 23, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-23/pdf/2020-07449.pdf; Regulatory Capital Rule: Transition for the Community Bank Leverage Ratio Framework, 85 Fed. Reg. 22930 (Apr. 23, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-23/pdf/2020-07448.pdf.

[22] *See* Real Estate Appraisals, 85 Fed. Reg. 21312 (Apr. 17, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-17/pdf/2020-08216.pdf.

[23] *See* FDIC, FIL-30-2020, Statement on Part 363 Annual Reports in Response to the Coronavirus (Mar. 27, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20030.html.

[24] *See* Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 2021: Federal Deposit Insurance, 85 Fed. Reg. 67428 (Oct. 23, 2020), available at https://www.fdic.gov/news/board/2020/2020-10-20-notice-dis-c-fr.pdf; Temporary Asset Thresholds, 85 Fed. Reg. 77345 (Dec. 2, 2020), available at https://www.fdic.gov/news/board/2020/2020-11-17-notational-fr-a.pdf.

[25] *See* FDIC, FDIC Quarterly, Quarterly Banking Profile: Third Quarter 2020, Volume 14, No. 4 (2020), at 31, available at https://www.fdic.gov/bank/analytical/quarterly/2020-vol14-4/fdic-v14n4-3q2020.pdf.

[26] *See* FDIC, Frequently Asked Questions on the Small Business Administration's Paycheck Protection Program (Apr. 5, 2020), available at https://www.fdic.gov/coronavirus/smallbusiness/faq-sb.pdf.

[27] *See* FDIC FIL-33-2020, New SBA and Treasury Programs Available for Small Business Relief (Apr. 2, 2020), available at https://www.fdic.gov/news/news/financial/2020/fil20033.html.

[28] *See* Regulatory Capital Rule: Paycheck Protection Program Lending Facility and Paycheck Protection Program Loans, 85 Fed. Reg. 20387 (Apr. 13, 2020), available at https://www.govinfo.gov/content/pkg/FR-2020-04-13/pdf/2020-07712.pdf.

(LCR) effects[29] of participating in the Federal Reserve's PPP lending facility. We later issued a final rule to mitigate the deposit insurance assessment effect of participating in the PPP.[30]

**D. *Maintaining the Deposit Insurance Fund***

The Deposit Insurance Fund (DIF) balance was $117.9 billion on December 31, up $1.5 billion from the end of the third quarter and the highest level ever.[31] However, the reserve ratio declined one basis point to 1.29 percent because of strong insured deposit growth, and not as the result of losses to the DIF. In September 2020, the FDIC adopted a Restoration Plan to restore the reserve ratio to at least the statutory minimum of 1.35 percent within eight years, absent extraordinary circumstances, as required by the Federal Deposit Insurance Act.[32] In accordance with the Restoration Plan, FDIC staff continues to monitor closely the factors that affect the reserve ratio.

## III. Resolution Readiness

Throughout the pandemic, the FDIC has continued its work on enhancing our resolution readiness, both in the short-term and in the long run. As the FDIC responded to the immediate impact of the pandemic, we established a new approach to closing failed banks 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.

Our work in 2019 to form a new division – the Division of Complex Institution Supervision and Resolution – centralized our supervision and resolution activities for banks with more than $100 billion in total assets for which the FDIC is not the primary regulator.[33] This centralized approach has greatly improved the FDIC's ability to prepare for resolution of larger banks and enhanced our preparedness in the event of a crisis. Last fall, we added additional experience to the agency's Systemic Resolution Advisory Committee, a committee that brings together expertise inside and outside the agency to discuss the challenges, opportunities, and progress being made to implement our systemic resolution mission.[34]

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[29] *See* Liquidity Coverage Ratio Rule: Treatment of Certain Emergency Facilities, 85 Fed. Reg. 26835 (May 6, 2020), available at https://www.fdic.gov/news/board/2020/2020-04-30-notational-fr.pdf.

[30] *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.

[31] *See* Quarterly Banking Profile, Fourth Quarter 2020, *supra* note 2.

[32] *See* FDIC, FIL-90-2020, Restoration Plan for the FDIC Deposit Insurance Fund (Sept. 15, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20090.html.

[33] *See* FDIC, 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.

[34] *See* FDIC, FDIC Advisory Committees: Systemic Resolution Advisory Committee (SRAC), available at: https://www.fdic.gov/about/advisory-committees/systemic-resolutions/index.html.

The FDIC has also worked closely with our international counterparts, including the Bank of England and the Single Resolution Board of the European Union, to monitor and prepare for cross-border resolution of global systemically important banks (GSIBs).[35] The FDIC and Federal Reserve are co-Chairs of the Crisis Management Groups for U.S. GSIBs, where we engage with firms and domestic and foreign authorities to facilitate cross-border resolution planning. We participate in financial regulatory dialogues, such as the U.S.-EU Joint Financial Regulatory Forum[36] and the U.S.-UK Financial Regulatory Working Group,[37] which are avenues for enhanced cooperation on cross-border resolution planning. We also remain active in the work on cross-border resolution cooperation that occurs in international fora, such as the Financial Stability Board, by participating in its Resolution Steering Group, among other contributions.

The FDIC continues to review resolution plans submitted under Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act. In addition, in January of this year, the FDIC announced plans to resume requiring resolution plans for insured depository institutions (IDIs), or IDI plans, for firms with $100 billion or more in assets.[38] The FDIC is working on providing additional details in the coming weeks regarding future implementation of the IDI rule.

## IV. Supervisory Process and Regulatory Actions

### A. *Supervisory Process*

Maintaining our Supervisory Programs and Examinations

As we responded to the challenges of the pandemic, the FDIC maintained its supervisory programs for both safety and soundness and consumer protection and worked with institutions that were experiencing operational challenges. The majority of institutions have had no difficulty continuing ongoing FDIC supervisory activities, and only a small number have asked for brief delays due to pandemic-related operational challenges or on-site document access limitations.

The FDIC has also conducted heightened monitoring of financial institutions whose activities or concentrations may have made them more vulnerable to the economic consequences of the pandemic. We have expanded our regular risk monitoring activities, particularly for

[35] *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.

[36] *See* U.S. Department of the Treasury, Joint Statement on the U.S.-EU Joint Financial Regulatory Forum (March 29, 2021), available at https://home.treasury.gov/news/press-releases/jy0084.

[37] *See* U.S. Department of the Treasury, Joint Statement on UK-U.S. Financial Regulatory Working Group Meeting (Oct. 22, 2020), available at https://home.treasury.gov/news/press-releases/sm1160.

[38] *See* FDIC, FDIC Announces Lifting IDI Plan Moratorium (Jan. 19, 2021), available at https://www.fdic.gov/resauthority/idi-statement-01-19-2021.pdf; *see also* 12 C.F.R. § 360.10.

institutions that have concentrated exposures to the industries that have been most impacted by the pandemic.

Throughout this period, the FDIC contacted all 50 state banking commissioners, conducted regular meetings with our federal bank regulatory counterparts, spoke to members of Congress, reached out to consumer groups, and maintained regular contact with supervised institutions. These engagements helped us better react to the challenges facing banks and communities across the nation.

Supervisory Engagement Going Forward

As the pandemic struck, the FDIC was forced to move our examination work off-site seemingly overnight, to protect our employees and the staff at banks we supervise. That we were able to transition effectively is a testament to the flexibility of the FDIC workforce and the institutions we supervise. Moreover, it resulted in the growing realization of how much can be accomplished in an examination that takes full advantage of technology.

As the effects of the pandemic fade, we look forward to returning to on-site exams at banks. These interactions help our examiners understand the institutions we supervise, and they provide useful engagement for bankers. But as our institutions evolve, the way we supervise them is evolving as well. Investments in new technology can help reduce the amount of time that examination teams spend on-site at supervised institutions, contributing to quicker examination turnaround and report processing, while strengthening our ability to monitor risk in a more timely manner. The pandemic, and our ability to adjust to it quickly while still fulfilling the agency's mission, have demonstrated that technology can enable us to maintain smaller on-site teams with the remote support of larger off-site teams. This change will reduce travel commitments that have exacted a toll on our examiners and their families, especially those with young children, and thereby can improve retention of examiners.

These advances can also facilitate a more fundamental policy objective: the necessary evolution of our supervision and examination processes from static, point-in-time assessments to more routine engagement and timely analyses that will enhance our ability to monitor, identify, and mitigate risk at individual institution and in the financial system as a whole.

**B. *Regulatory Actions***

Brokered Deposits

At the end of 2020, the FDIC Board approved a final rule updating our brokered deposits regulations, the first meaningful update to the brokered deposits regulations since the rules were first put in place approximately 30 years ago. As the banking sector transformed over those decades, the FDIC received many questions regarding whether specific deposit arrangements were brokered or not. The agency typically responded on a one-off basis, resulting in a fragmented legal framework. Meanwhile, many types of deposit arrangements that bear little resemblance to the brokered deposits of the 1980s were categorized as brokered under the regulation.

The new rule is intended to encourage innovation in how banks offer services and products to customers by removing regulatory hurdles to certain types of innovative partnerships between banks and fintechs.[39] The final rule accomplishes this by tailoring the scope of deposits captured to align more closely with the types of deposits Congress intended to capture when the restrictions were first put in place. The rule also creates a more transparent and consistent regulatory approach by providing a clearer description of the criteria for meeting the "facilitation" prong of the deposit broker definition and establishing a consistent process for application of the primary purpose exception.

The final rule became effective on April 1, with an optional extended compliance date of January 1, 2022. The FDIC created a dedicated webpage that contains information relevant to the regulation, including filing instructions for the notice and application process.[40]

Although the new framework represents an important step forward, the brokered deposits statute will continue to present inevitable implementation challenges. In 2019, I suggested that Congress consider replacing Section 29 of the Federal Deposit Insurance Act, the section imposing restrictions on brokered deposits, with a simple restriction on asset growth for troubled institutions.[41] This would be a far simpler regime for the FDIC and industry to administer, and would more directly address the problem Congress was trying to tackle in the original legislation. I continue to believe that a simple restriction on asset growth for troubled institutions would be a superior approach in the long run.

Industrial Banks

In December of last year, we finalized a rule to codify and clarify legally enforceable commitments we generally require insured industrial banks and industrial loan companies (collectively, industrial banks) and their parent companies to enter into as a condition of approval.[42] These commitments include capital and liquidity maintenance agreements (CALMAs), which contractually obligate a parent company to serve as a source of strength for an industrial bank. The rule provides transparency to potential future applicants and the public regarding the FDIC's requirements for parent companies of industrial banks and ensures that all parents of industrial banks approved for deposit insurance going forward are subject to such required commitments.

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[39] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 86 Fed. Reg., 6742 (Jan. 22, 2021), available at https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-a-fr.pdf.

[40] *See* FDIC, Banker Resource Center: Brokered Deposits, available at https://www.fdic.gov/resources/bankers/brokered-deposits/.

[41] *See* FDIC Chairman Jelena McWilliams, "Brokered Deposits in the Fintech Age," speech before the Brookings Institution (Dec. 11, 2019), available at https://www.fdic.gov/news/news/speeches/spdec1119.html.

[42] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703 (Feb. 23, 2021), available at https://www.fdic.gov/news/board/2020/2020-12-15-notice-dis-b-fr.pdf.

Computer-Security Incident Notification

Also at the end of 2020, we issued a proposed rule together with the OCC and Federal Reserve to enhance reporting of computer-security incidents by requiring notification within 36 hours of knowledge of covered incidents.[43] The proposal would enable regulators to understand quickly if regulated banks have been the victim of a serious computer-security incident that may "materially disrupt, degrade, or impair" the bank's operations or threaten the financial stability of the United States. The proposed rule seeks to provide balance – avoiding unnecessarily difficult or time-consuming reporting obligations while permitting regulatory agencies to be in a position to provide assistance to a bank or the broader financial system when significant computer-security incidents occur. We are in the process of considering the comment letters received in response to that proposal and engaging with our fellow regulatory agencies as we move to issue the final rule.

Suspicious Activity Reports

In January 2021, the FDIC issued a notice of proposed rulemaking to permit the agency to grant case-by-case suspicious activity report (SAR) filing exemptions to FDIC-supervised institutions that develop an innovative approach to suspicious activity reporting requirements.[44] The other federal banking agencies issued similar notices. The rule would allow for the issuance of SAR exemptions in lockstep with the Financial Crimes Enforcement Network (FinCEN). The FDIC is also working with FinCEN and the other federal banking agencies to implement the requirements of the Anti-Money Laundering Act (AML Act) and the Corporate Transparency Act (CTA).

Supervisory Appeals

This past January, we finalized a proposal to establish a new Office of Supervisory Appeals to hear appeals by banks of material supervisory determinations made by examiners.[45] Historically, the FDIC's appeals process was rarely used. From the beginning of 2007 through the end of 2020, only about 50 appeals were filed out of more than 110,000 exams.[46] Reviewing officials in the new office, which we are currently in the process of setting up, will be devoted

[43] *See* Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers, 86 Fed. Reg. 2299 (Jan. 12, 2021), available at https://www.govinfo.gov/content/pkg/FR-2021-01-12/pdf/2020-28498.pdf.

[44] *See* FDIC, FIL-11-4-2020, Proposed Rulemaking to Permit Additional Exemptions to Suspicious Activity Report Requirements (Dec. 15, 2020), available at https://www.fdic.gov/news/financial-institution-letters/2020/fil20114.html.

[45] *See* FDIC, FIL 04-2021, Revised Guidelines for Appeals of Material Supervisory Determinations (Jan. 19, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21004.html.

[46] Total appeals includes a number of appeals that were not decided upon because the appeal was withdrawn by the institution, the issues were found not to be appealable, or the institution closed. Total exams includes safety and soundness, trust, information technology, Bank Secrecy Act, consumer protection, and Community Reinvestment Act examinations conducted by FDIC as primary federal supervisor.

solely to hearing appeals, providing time and capacity for the proper attention and diligence. Our new appeals process will help promote consistency among examiners across the country, ensure accountability at the agency, and ultimately, help maintain stability and public confidence in the nation's financial system.

Supervisory Guidance

This past January, we approved a final rule regarding the role of supervisory guidance.[47] The final rule clarifies the differences between regulations and guidance, and makes clear that supervisory guidance does not create binding, enforceable legal obligations. Guidance can play an important role in providing clarity to supervised institutions, but, unlike a law or regulation, guidance is not an appropriate basis on which to take enforcement action. The rule further clarifies that the FDIC will not issue supervisory criticisms for violations of supervisory guidance. We also affirmed that we do not make supervisory recommendations solely on the basis of reputational risk.

## V. Financial Inclusion

The health of the banking sector affects our communities in many ways, not least of all in standing ready to provide access to checking or savings accounts and other critical financial services. Creating an inclusive financial system has been one of my priorities as Chairman, and is rooted in my own experiences as an immigrant to this country. Because the FDIC is a bank regulatory agency, we have approached this issue from the perspective of financial services.

### A. *How America Banks Report*

The FDIC has seen meaningful improvements in recent years in reaching the "last mile" of unbanked households in this country. Based on the results of our biennial survey of households, the proportion of U.S. households that were banked in 2019 – 94.6 percent – was the highest since the survey began in 2009.[48] Notwithstanding these improvements, we know that much remains to be done. Over 7 million households do not have a banking relationship to deposit their checks or with which to save for unexpected expenses.[49] 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.[50] Similarly, Black and Hispanic households across all income levels are less likely to use forms of bank credit (e.g., a credit card,

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[47] *See* FDIC, FDIC Approves Rule on the Role of Supervisory Guidance (January 19, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21005.html.

[48] *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.

[49] *See id*. at 1.

[50] *See id*. at 2.

personal loan, or line of credit from a bank).[51] Savings rates remain lower among these households,[52] which results in greater difficulty dealing with unexpected expenses.[53]

To help address these disparities, the FDIC is using its authorities to support a safer, fairer, and more inclusive banking system. We have recently launched a targeted public awareness campaign, #GetBanked, to inform consumers about the benefits of developing a relationship with a bank. Having a basic checking account can be an important first step to becoming part of the financial fabric of this country and we are pleased that an increasing number of banks are offering low-cost and no-fee accounts that work for people with limited means.

**B. *Mission-Driven Banks***

As the supervisor of the majority of the nation's community banks, including minority depository institutions (MDIs) and Community Development Financial Institutions (CDFIs), the FDIC also plays an important role in ensuring these institutions can meet the needs of their customers and communities.[54] In November 2020, we announced the establishment of the Mission-Driven Bank Fund that will channel private sector investments to support MDIs and CDFIs, through a variety of asset classes.[55] We have engaged a financial advisor and two law firms to develop the framework, structure, and concept of operations for the fund, but the FDIC will not manage the fund, contribute capital to the fund, or be involved in the fund's investment decisions. Our goal is for anchor investors to hire a fund manager in the second quarter of 2021, conduct a fundraising round, and be prepared for the fund to accept pitches from MDIs and CDFIs in the third quarter.

**C. *Diversity, Equity, and Inclusion***

The FDIC recently released a new diversity strategic plan outlining five "C"s – Culture, Career, Communication, Consistency, and Community – designed to help guide us on our

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[51] *See id*. at 8.

[52] *See id*. at 52.

[53] *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.

[54] Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) 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.

[55] *See* FDIC, 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.

journey to support diversity, equity, and inclusion.[56] The plan contains actionable steps that will guide our work over the next few years and help us measure our progress. We will further integrate diversity, equity, and inclusion into our hiring, training, and career development programs, enhance accountability within the organization, and provide additional support for MDIs. The FDIC has made much progress in these areas over the years, but we know we can do more, and we will.

### D. *Support for the Emergency Capital Investment Program*

We have also taken steps to facilitate the timely implementation and acceptance of the Emergency Capital Investment Program (ECIP), which was created by the Department of the Treasury pursuant to the Consolidated Appropriations Act, 2021. The ECIP enables the Treasury to make capital investments in certain low- and moderate-income community financial institutions. The FDIC, together with the OCC and Federal Reserve, issued an interim final rule in March 2021 that will facilitate the implementation of the ECIP by providing certainty that the preferred stock issued under the program qualifies as additional tier 1 capital and that subordinated debt issued under the program qualifies as tier 2 capital under the regulatory capital rule.[57]

## VI. Fostering Innovation and American competitiveness

The rapid transformation of our lives in the past year has amplified how critical innovation is to enabling banks and communities to meet the challenges of the pandemic and to ensuring that American banks remain competitive in a rapidly changing world. Early in my tenure at the FDIC, we established a new Office of Innovation – FDiTech – to promote innovation at the agency and across the banking sector,[58] and we hired our first Chief Innovation Officer earlier this year.[59]

### A. *Rapid Prototyping*

Last year, we also announced a rapid prototyping competition, a type of tech sprint. For this competition, our challenge was to promote more regular reporting from community banks, where technology levels vary greatly, without increasing reporting burdens or costs. More than 30 technology firms were invited to participate in this competition,[60] and we have reviewed

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[56] *See* FDIC, FDIC Releases Strategic Plan to Reinforce Diversity, Equity, and Inclusion Within the Agency and Among the Financial Institutions It Supervises (Mar. 3, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21016.html.

[57] *See* Regulatory Capital Rule: Emergency Capital Investment Program, 86 Fed. Reg. 15076 (Mar. 22, 2021), available at https://www.fdic.gov/news/board/2021/2021-03-05-notational-fr.pdf.

[58] *See* Remarks by Jelena McWilliams, FDIC Chairman, "The Future of Banking," The Federal Reserve Bank of St. Louis (Oct. 1, 2019), available at https://www.fdic.gov/news/speeches/spoct0119.html.

[59] *See* "FDIC Appoints First Chief Innovation Officer" (Feb. 16, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21009.html.

[60] *See* FDIC, FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html.

prototypes from the 11 vendors that made it to phase three of the competition.[61] The technologies demonstrated by these vendors show great promise, and we are reviewing the legal, regulatory, and contractual framework needed to successfully encourage the market to adopt technologies like this. Tools like those developed in this competition will help pave the way for more seamless and timely reporting of more granular data in the future for banks that voluntarily choose to adopt them.

### B. *Artificial Intelligence*

In March of this year, alongside our fellow regulators, we issued an interagency request for information (RFI) on financial institutions' use of artificial intelligence (AI).[62] AI can offer a range of benefits for banks, consumers, and businesses, such as expanding credit access through innovative use of data and faster underwriting. As we receive and review comments to the RFI, we will be particularly interested in feedback on how financial institutions use AI, whether AI is helpful to them, and whether additional regulatory clarity would be helpful.

AI and alternative data can be especially important for small businesses, such as sole proprietorships and smaller companies owned by women and minorities. Such businesses often do not have a long credit history, which is why novel measures of creditworthiness, like income streams, can help provide critical access to capital, particularly in difficult times.

### C. *Digital Assets*

On May 17, the FDIC issued an RFI seeking comment on banks' current and potential activities related to digital assets. We have been closely following developments in the emerging digital asset ecosystem for some time. Banks have increasingly begun exploring a variety of potential roles, such as being custodians, reserve holders, issuers, and exchange or redemption agents; performing node functions; and holding digital asset issuers' money deposits. The FDIC is issuing the RFI to better understand current and potential use cases involving IDIs and their affiliates.

## VII. Conclusion

Although I am cautiously optimistic that the worst of the pandemic is behind us and that the nation can establish a "new normal," we remain vigilant about economic conditions and the uneven impact of the pandemic and its recovery on different populations throughout the United States. As they have throughout this unprecedented time, the FDIC's 5,845 dedicated employees remain committed to the agency's mission and the financial stability of the United States, as well as its role in supporting a financial system that serves all Americans.

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[61] *See* FDIC, FDIC Selects 11 Companies to Compete in Final Phase of Tech Sprint (Jan. 11, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21004.html.

[62] *See* Request for Information and Comment on Financial Institutions' Use of Artificial Intelligence, Including Machine Learning, 86 Fed. Reg. 16837 (Mar. 31, 2021), https://www.govinfo.gov/content/pkg/FR-2021-03-31/pdf/2021-06607.pdf.

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Statement by

Randal K. Quarles

Vice Chair for Supervision

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

May 19, 2021

Chairwoman Waters, Ranking Member McHenry, members of the Committee, thank you for the invitation to testify today. Last May, my colleagues and I came before you—in a virtual format for the first time—discussing our actions to maintain a strong banking sector as a source of support for consumers, households, and businesses. I'd like to thank the Committee for its flexibility and its commitment to ongoing, open dialogue, especially in the course of such a challenging year.

My remarks one year ago came after the onset of sudden and pervasive financial stress.[1] Early turmoil in overseas financial markets quickly crossed borders and, within days, had reached almost every asset class and corner of the financial system. From the beginning, the causes of this strain were clear, rooted in the policy measures taken to address the outbreak of COVID-19. But at that time, the full implications of the COVID event remained unclear, and the costs would continue to mount.

The American economy and banking sector then remained at the edge of the storm, with one wave of stress behind us and others yet to come. Today, the storm waters are receding. The economy is beginning a strong recovery, which owes much to an extraordinary, coordinated, and sustained campaign of support, by both Congress and the Federal Reserve, that helped clear a path to the other side of the COVID event.

As the Federal Reserve's recent reports detail, banking organizations have remained an important source of strength in this recovery.[2] Entering the COVID event, the banking system

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[1] Randal K. Quarles, "Supervision and Regulation Report" (testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C., May 12, 2020), https://www.federalreserve.gov/newsevents/testimony/quarles20200512a.htm.

[2] Board of Governors of the Federal Reserve System, *Supervision and Regulation Report, April 2021* (Washington: Board of Governors, April 2021), https://www.federalreserve.gov/publications/files/202104-supervision-and-regulation-report.pdf; Board of Governors of the Federal Reserve System, *Financial Stability Report, May 2021* (Washington: Board of Governors, May 2021), https://www.federalreserve.gov/publications/files/financial-stability-report-20210506.pdf. The *Supervision and Regulation Report* accompanies this testimony.

was fortified by over 10 years of work to improve safety and soundness, from both regulators and the banks themselves. Higher levels of capital and liquidity, better risk management, and more robust systems let them absorb an unprecedented shock—while providing refuge from market instability, delivering essential public aid, and working constructively to support borrowers and communities.[3] In short, the full set of post-2008 reforms—as refined and recalibrated by the work of the last four years—ensured that this time would truly be different than the last. Today, the U.S. banking system is actually more liquid and better capitalized than it was a year ago, with over $100 billion in additional loan loss reserves, leaving it well-positioned to weather future shocks.

While a strong recovery is underway, it is not yet complete.[4] Some households and businesses are still vulnerable, even as we enter this last stretch of the return to normal. Our role, as policymakers, is to support the financial system and the economy through the end of this transition back to normal operations. Our challenge, however, is to do so as circumstances change and the nation's need for that support evolves.[5]

Most immediately, we have worked to align our emergency actions with other relief efforts, as the economic situation improves. Last spring, the Federal Reserve adopted a set of extraordinary and mostly temporary measures to ease the strain in financial markets and ensure banks could support communities and meet customer needs.[6] In the last six months, we have

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[3] See Randal K. Quarles, "Remarks at the Hoover Institution" (speech at the Hoover Institution, Stanford, CA (via webcast), October 14, 2020), https://www federalreserve.gov/newsevents/speech/quarles20201014a htm.
[4] See, e.g., Jerome H. Powell, "Getting Back to a Strong Labor Market" (speech at the Economic Club of New York (via webcast), February 10, 2021), https://www federalreserve.gov/newsevents/speech/powell20210210a.htm.
[5] See Jerome H. Powell, "Community Development" (speech at the "2021 Just Economy Conference" sponsored by the National Community Reinvestment Coalition, Washington, D.C. (via webcast), May 3, 2021), https://www.federalreserve.gov/newsevents/speech/powell20210503a htm ("Lives and livelihoods have been affected in ways that vary from person to person, family to family, and community to community").
[6] For a catalogue of these actions, see "Supervisory and Regulatory Actions in Response to COVID-19," Board of Governors of the Federal Reserve System, last updated March 15, 2021, https://www.federalreserve.gov/supervisory-regulatory-action-response-covid-19.htm.

maintained or extended some of those measures, where appropriate, to preserve household assistance and promote continued access to credit.[7]

We also began the transition back to our normal activities, our normal supervisory posture, and our normal rulebook. We closed 12 of our 13 emergency lending facilities; let temporary changes to our leverage rules expire as planned; and announced plans to transition large banks back to our regular capital regulation program, calibrating dividend and share repurchase restrictions to the results of the upcoming supervisory stress tests.[8]

These are important near-term steps, and they are part of any responsible transition out of our emergency posture. However, our role and our responsibility extend much further than merely returning to normal. We also have an obligation to look closely at the last year, to understand how the financial system came to experience such severe stress, and to identify and act on any lessons we find. The COVID event was a unique shock, but it was also the first real-world test of the regulatory and supervisory regime established after the 2008 financial crisis. As

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[7] See, e.g., Board of Governors of the Federal Reserve System, "Federal Reserve Board announces it will extend its Paycheck Protection Program Liquidity Facility, or PPPLF, by three months to June 30, 2021," news release, March 8, 2021, https://www.federalreserve.gov/newsevents/pressreleases/monetary20210308a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board announces the second extension of a rule to bolster the effectiveness of the Small Business Administration's Paycheck Protection Program (PPP)," news release, February 9, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210209a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve announces the extension of its temporary U.S. dollar liquidity swap lines and the temporary repurchase agreement facility for foreign and international monetary authorities (FIMA repo facility) through September 30, 2021," news release, December 16, 2020, https://www.federalreserve.gov/newsevents/pressreleases/monetary20201216c.htm; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies provide temporary relief to community banking organizations," news release, November 20, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201120a htm.

[8] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Temporary supplementary leverage ratio changes to expire as scheduled," news release, March 19, 2021, https://www federalreserve.gov/newsevents/pressreleases/bcreg20210319b.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board announces that the temporary change to its supplementary leverage ratio (SLR) for bank holding companies will expire as scheduled on March 31," news release, March 19, 2021, https://www federalreserve.gov/newsevents/pressreleases/bcreg20210319a htm; Board of Governors of the Federal Reserve System, "Federal Reserve announces temporary and additional restrictions on bank holding company dividends and share repurchases currently in place will end for most firms after June 30, based on results from upcoming stress test," news release, March 25, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210325a htm.

such, it gives us a chance to examine that regime's strengths and shortcomings, and to position it well for future challenges.

Any list of lessons must begin with the strong performance of supervisory stress testing.[9] The stress-testing program not only prepared banks for a period of prolonged hardship; it also clarified their health and resilience as the COVID event progressed. This role was a return to the original purpose of stress testing and a confirmation of its earliest use during the 2008 financial crisis. It also, however, affirmed the ways that stress testing has evolved in recent years, into a more flexible, more transparent anchor for the Federal Reserve's broader capital program.

For example, while it was prudent—given that this was the first real-world test of the post-2008 system—for us to impose temporary capital distribution restrictions beyond those that form part of that system, we now know that our framework works. We can have particular confidence in the framework when it is supplemented and informed by a real-time stress testing regime. In the future, having learned the lessons of this test, we will be able to rely on the automatic restrictions of our carefully developed framework when the stress test tells us the system will be resilient, rather than impose *ad hoc* and roughly improvised limitations.

Other areas, however, are ripe for closer examination, both domestically and internationally. These include the strains in short-term funding markets, and the second destabilizing run on prime money market mutual funds in roughly a decade, which required significant public intervention to address.[10] Despite some efforts after the 2008 crisis to enhance

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[9] Randal K. Quarles, "Themistocles and the Mathematicians: The Role of Stress Testing" (speech at the Federal Reserve Bank of Atlanta, Atlanta, GA (via webcast), February 25, 2021), https://www.federalreserve.gov/newsevents/speech/quarles20210225a.htm; see also Board of Governors of the Federal Reserve System, "Federal Reserve Board announces results from second round of bank stress tests will be released Friday, December 18, at 4:30 p m. EST," news release, December 4, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201204a htm.

[10] Randal K. Quarles, "The FSB in 2021: Addressing Financial Stability Challenges in an Age of Interconnectedness, Innovation, and Change" (speech at the Peterson Institute for International Economics,

the resiliency of these investment vehicles, the basic model of a seemingly stable-value fund, backed by assets the value and liquidity of which varies, remained vulnerable. Work is ongoing both domestically and at the Financial Stability Board on how to better address these vulnerabilities.

Areas for further examination also include Treasury markets, where last year's selling pressures overwhelmed dealers' willingness or ability to intermediate, and which continue to be a focus for the Board, the Department of the Treasury, and other regulators.[11] Among other measures, we are reviewing the design and calibration of the supplementary leverage ratio, which was originally gauged for a financial system with far lower levels of cash reserves and a much smaller Treasury market.[12]

Finally, these areas for further review include a rapidly changing set of customer practices; changing patterns in the use of financial services, by consumers and businesses; and a changing relationship between banks and their nonbank partners. These trends predate the COVID event, but the past year accelerated them dramatically, with important implications for financial stability, safety and soundness, consumer protection, and underserved communities' access to safe and fair financial services. The Federal Reserve is working to understand and address this changing landscape in a number of ways—from the use of artificial intelligence, to the evolving need for operational resiliency, to the growing risk of disruptive shocks from cybersecurity failures.[13]

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Washington, D.C. (via webcast), March 30, 2021), https://www.federalreserve.gov/newsevents/speech/quarles20210330a.htm.

[11] 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.

[12] See note 8, Board of Governors of the Federal Reserve System, news release, March 19, 2021.

[13] Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency,

We are not alone in our work to understand these post-COVID-event lessons. We have valuable and willing partners in our fellow regulators, in other agencies across government, and in our colleagues abroad. We continue to participate actively in relevant work at the Financial Stability Board and other international forums, since financial risks do not respect the jurisdictional lines between agencies or countries. And we are committed to keeping Congress closely and actively informed of our efforts, mindful of the effect these trends may have on our core mandate.

This work is critical, but only in service of a more fundamental goal: a safe, transparent, and efficient approach to supervision and regulation, which ensures the financial system is strong and stable enough to withstand even historic shocks.[14] Those values are of perennial importance, and they continue to be the bedrock of the Federal Reserve's work.[15] They also animate two of our highest priorities for this year: to finalize the post-crisis Basel III reforms and to complete the long-overdue transition away from LIBOR. On the former, we remain committed to implementing Basel III for our internationally active banking organizations in a full, timely, and consistent manner, with a rulemaking proposal for public comment later this year. For LIBOR,

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"Agencies seek wide range of views on financial institutions' use of artificial intelligence," news release, March 29, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210329a.htm; Board of Governors of the Federal Reserve System, SR letter 20-24: "Interagency Paper on Sound Practices to Strengthen Operational Resilience," November 2, 2020, https://www.federalreserve.gov/supervisionreg/srletters/SR2024.htm; see also "Jerome Powell: Full 2021 60 Minutes Interview Transcript," *60 Minutes Overtime*, April 11, 2021, https://www.cbsnews.com/news/jerome-powell-full-2021-60-minutes-interview-transcript/.

[14] Randal K. Quarles, "The Eye of Providence: Thoughts on the Evolution of Bank Supervision" (speech at the Federal Reserve Board, Harvard Law School, and Wharton School Conference: Bank Supervision: Past, Present, and Future (via webcast), December 11, 2020), https://www.federalreserve.gov/newsevents/speech/quarles20201211a.htm.

[15] Board of Governors of the Federal Reserve System, "Federal Reserve Board adopts final rule outlining and confirming the use of supervisory guidance for regulated institutions," news release, March 31, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210331a.htm; Board of Governors of the Federal Reserve System, "Federal Reserve Board publishes frequently asked questions (FAQs) comprising existing legal interpretations related to a number of the Board's longstanding regulations," news release, March 31, 2021, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210331b.htm; Board of Governors of the Federal Reserve System, "Federal Reserve publishes latest version of its supervision and regulation report," news release, November 6, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201106a.htm.

by contrast, the time for comment, speculation, and delay has long since passed. Continued use of LIBOR in new contracts after 2021 would create safety and soundness risks, and we will examine bank practices accordingly.[16]

The COVID event is not behind us, and the vulnerabilities it exposed are not gone. As we continue to recover, the "vast influence of accident" can only grow, with consequences that can disproportionately fall on the most vulnerable.[17] However, we can do more than just wait and hope that the path out of the COVID event is smooth. We can work to ensure the financial system is resilient enough to support consumers, households, and businesses, and we can recommit ourselves to supporting the economy through the completion of the recovery. The work we undertake to learn the lessons of the past year is a critical step in upholding that commitment.

Thank you. I look forward to your questions.

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[16] Randal K. Quarles, "Keynote Remarks" (speech at "The SOFR Symposium: The Final Year," an event hosted by the Alternative Reference Rates Committee, New York, NY (via webcast), March 22, 2021), https://www.federalreserve.gov/newsevents/speech/quarles20210322a.htm; see also Mark Van Der Weide, "The End of LIBOR: Transitioning to an Alternative Interest Rate Calculation for Mortgages, Student Loans, Business Borrowing, and Other Financial Products" (testimony before the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Committee on Financial Services, U.S. House of Representatives, Washington, D.C., April 15, 2021), https://www.federalreserve.gov/newsevents/testimony/vanderweide20210415a htm.

[17] Thucydides, *The History of the Peloponnesian War*, translated by Richard Crawley, at Ch. 3, https://www.gutenberg.org/files/7142/7142-h/7142-h htm.

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May 18, 2021

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Chairwoman Waters and Ranking Member McHenry,

On behalf of the Credit Union National Association (CUNA), I am writing regarding the hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions." CUNA represents America's credit unions and their more than 120 million members.

We commend the steps taken by the National Credit Union Administration (NCUA) under the leadership of Chairman Todd Harper, former Chairman Rodney Hood and Vice Chairman Kyle Hauptmann to implement policies during the COVID-19 pandemic that enabled credit unions to work to improve their members' financial well-being and advance the communities that they serve.

As the Committee exercises its critical oversight function of NCUA, we offer perspective on a number of pending issues and concerns, including the legislation described in the Committee memorandum for this hearing, NCUA's continued work on COVID-19 related policy accommodations, the need for NCUA to have flexibility with respect to prompt corrective action (PCA) requirements, the state of credit unions' diversity, equity and inclusion (DEI) journey, our concern with proposals to adjust the National Credit Union Share Insurance Fund (NCUSIF), our support for additional charter enhancement legislation that will further enable credit unions to focus on their members' financial well-being, and concerns raised by banking trade associations regarding the small number of bank sales to credit unions.

**Pending Legislation**
The hearing memo includes an appendix listing several legislative proposals under consideration. We offer our views on four of these bills that impact credit unions.

*H.R. ___, Expanding Financial Access for Underserved Communities Act*
The Expanding Financial Access for Underserved Communities Act would make three changes to the Federal Credit Union Act to enable and encourage credit unions to serve underserved and abandoned communities and promote financial inclusion.

First, the legislation would allow all federal credit unions to add underserved areas to their field of membership. Under current law, only multiple common bond credit unions can add underserved communities. Second, the legislation exempts business loans made by credit unions to businesses in underserved areas from the credit union member business lending cap. Finally, the legislation expands the definition of an underserved area to include any area that is more than 10 miles from the nearest branch of a financial institution. Currently, there are two other ways that an area can qualify as underserved: (1) CDFI Area or (2) New Markets Tax Credit Area. Adding this third path for an area to be designated underserved is designed to address the epidemic of rural banking deserts and ensure the availability of cooperative financial services for all.

Any serious discussion of policy remedies to address access to financial services to underserved or unbanked persons, businesses and communities must include breaking down barriers in law and regulation that keep credit unions from being part of the solution. Credit unions' field of membership restrictions and the member business lending cap shut out those that need access to mainstream financial services. This legislation is not a panacea to these exclusionary policies, but it does represent a solid step forward toward financial inclusion. We strongly support this legislation and appreciate its consideration.

*H.R. ____, Central Liquidity Facility Enhancement Act*
The Central Liquidity Facility Enhancement Act would make permanent changes made to the NCUA's Central Liquidity Facility (CLF) by the CARES Act in 2020. These changes expanded the CLF's borrowing authority and made it easier for credit unions to join the CLF through their corporate credit union. CUNA has previously advocated for Congress to make these changes permanent and, therefore, we support this legislation.

*H.R. ____, NCUA Oversight of Third Party Vendors Act*
The NCUA Oversight of Third Party Vendors Act would restore the authority that NCUA enjoyed leading up to the Year 2000 transition (Y2K) to examine credit union service organizations (CUSOs) and other third party vendors used by credit unions. This authority, which was targeted to the specific circumstances surrounding Y2K, expired in 2001.

We are naturally skeptical of legislation that conveys new power, authority, or expectation on NCUA, particularly in areas where they have minimal or no expertise. Nevertheless, we recognize that threats such as cybersecurity breaches and money laundering impact credit unions and the credit union system. Credit unions often rely on CUSOs and/or third-party vendors to deliver products and services to their members and expect limited exposure to these threats. Therefore, we understand that there may be instances where NCUA's involvement is warranted for supervising critical CUSOs and vendors that present material risks to the credit union system. Further, we acknowledge that such authority, appropriately and measuredly applied, could benefit credit unions, especially small credit unions, by satisfying part of their due diligence responsibilities when contracting with third party vendors.

That said, we are unable to support legislation that would provide the agency with unfettered authority to supervise all CUSOs and vendors. We would like to work with the Committee to tailor this legislation so that it targets high risk areas such as cyber security and anti-money laundering relationships and ensures that credit unions do no pay higher direct or indirect costs as a result of the agency exercising this new authority.

*H.J. Res. 35, Resolution of Disapproval on the OCC's National Banks and Federal Savings Associations as Lenders Final Rule*
In what appears to be a blatant attempt by an unelected regulatory agency to weaken state laws, in July 2020, the OCC issued a Notice of Proposed Rulemaking (NPRM) related to determining the "true lender" in partnerships between national banks and third parties, including marketplace lenders. Under the proposal, a national bank would be considered the true lender of the loan if, as of the date of origination, it is named as the lender in the loan agreement or funds the loan.

CUNA has significant concerns with the "true lender" rule as it could be exploited to promote "rent-a-charter" arrangements between payday lenders and national banks, which can be used to evade state restrictions on high interest rates or loan terms. We believe the OCC's final rule is not in the best interest of consumers and should be withdrawn. Instead, the OCC, in coordination with its sister banking regulators, should focus its relief efforts on facilitating and promoting the fair and reasonable loan options that are offered by local-community based lenders like credit unions.

CUNA has long held the position that similar products and services should be regulated similarly so that consumer protection runs with a product or service, not with the entity providing the product or service. Credit unions and banks are subject to most of the same consumer protection laws. While not perfect, these requirements help protect consumers. Unfortunately, clever fin-techs and other institutions can use partnerships with banks and possibly a banking charter to avoid consumer protections with the approval of the OCC.

CUNA supports the Congressional Review Act resolution and believes it is the right course of action. A reversal by the OCC could be challenged in court and divert resources from the OCC. Furthermore, it is unclear if the next Comptroller would even be willing to reverse the rule.

**NCUA Should Continue Its COVID-19 Policy Accommodations**
We appreciate the steps the agency has taken the past year to address pressures on credit unions in connection with the ongoing COVID-19 pandemic. These include several interim final rules, including a recently adopted interim final rule that continues relief provided in a 2020 rule related to prompt corrective action (PCA).[1] We are hopeful that the agency will remain responsive and open to the needs of credit unions and their members during this global crisis.

In particular, the NCUA can provide additional regulatory relief by finalizing two outstanding rulemakings: the Capitalization of Interest in Connection with Loan Workouts and Modifications proposal,[2] and the Transition to the Current Expected Credit Loss Methodology proposal.[3] Given the urgency of the pandemic, the ensuing economic crisis, and the adverse impact these events are having on consumers' financial well-being, we strongly urge the Board to approve these proposals as soon as possible.

Existing regulation prohibits capitalization of interest, complicating loan modifications and workouts for members facing financial distress. The Capitalization of Interest in Connection with Loan Workouts and Modifications proposal issued by the NCUA Board in November 2020, would remove the existing prohibition on credit unions' capitalizing interest in connection with loan workouts and modifications.

In January, we filed a letter with the NCUA in support of the capitalization of interest proposal.[4] The current prohibition on capitalization of interest is overly burdensome and, in some cases, may hamper a credit union's good-faith efforts to engage in loan workouts with borrowers facing difficulty because of the economic disruption caused by the ongoing pandemic. Once adopted (and upon becoming effective), credit unions and their members will be able to begin taking advantage of the benefits of this rulemaking.

Proposed by the Board in July 2020, the Transition to the Current Expected Credit Loss Methodology rulemaking would provide that, for purposes of determining a credit union's net worth classification under PCA, the NCUA will phase-in over a three-year period the day-one adverse effects on regulatory capital that may result from adoption of the Financial Accounting Standards Board's (FASB) current expected credit losses (CECL) standard. Last October, we filed a letter with the NCUA in support of the CECL phase-in proposal.[5] We believe a three-year phase-in is appropriate. Not only does it conform with the flexibility provided by the federal banking agencies, it

[1] 86 Fed. Reg. 73 (Apr. 19, 2021).
[2] 85 Fed. Reg. 78,269 (Dec. 4, 2020).
[3] 85 Fed. Reg. 50,963 (Aug. 19, 2020).
[4] CUNA Letter to NCUA re Capitalization of Interest NPR (Jan. 26, 2021), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2021/Letters/012621_Capitalization%20of%20Interest_final.pdf.
[5] CUNA Letter to NCUA re Transition to CECL NPR (Oct. 19, 2020), *available at* https://www.cuna.org/uploadedFiles/Advocacy/Actions/Comment_Calls,_Letters_and_Testimonies/2020/Comment_Letters/CL%20-%20NCUA%20-%20NPR%20-%20Transition%20to%20CECL%20Methodology_final.pdf.

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also provides a sufficient amount of time for credit unions to spread out the effect of the day-one adjustment. While a phase-in would not apply until the CECL standard goes into effect in January 2023, the assurance that a phase-in will occur will be helpful as credit unions continue to prepare for CECL implementation.

We appreciate the Board's support of these rulemakings, and we are encouraged by its interest in pursuing such positive regulatory measures. We urge the NCUA to finalize these rules as soon as possible.

**PCA Flexibility**
While regulators across government took swift and appropriate action to implement accommodations to help regulated entities navigate the pandemic and ensuring economic crisis, in some cases, the COVID-19 pandemic exposed areas of law that do not provide sufficient crisis flexibility. Credit union prompt corrective action (PCA) requirements are one such area.

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. Having these requirements in the statutory text restricts NCUA's ability to provide accommodations to otherwise healthy credit unions impacted by natural disasters, pandemics, and other crises. This has been an issue of concern for us since the PCA standards were enacted into law in 1998; and, in the aftermath of Hurricane Katrina, we first urged the Committee to address the issue.

Credit unions entered the pandemic very well capitalized; as a system, average credit union capital stood at 11.4% at the beginning of 2020. As the pandemic took hold and the economy shut down, lending slowed, and deposits increased dramatically, particularly after economic impact payments were made to help consumers during the crisis. Deposits are a liability on the books of credit unions which means an increase in deposits puts downward pressure on capital ratios. Lower capital ratios draw supervisory scrutiny. As a credit union approaches the 7% statutory benchmark to be considered well-capitalized, it must take action to slow the decline – perhaps by disincentivizing deposits – because if the credit union falls below 6%, it must develop a net worth restoration plan.

During this crisis, as with most natural disaster related economic events, the decline in the capital ratio was not an indicator of an unhealthy credit union but rather an indicator of the impact of an event that was widely considered to be temporary. As such, NCUA took some steps – which we commend – to provide flexibility to credit unions impacted by economic impact payments and other deposit influxes. However, the law did not permit the agency flexibility to forbear net worth restoration plans in the event a credit union dropped below 6% net worth. The consequence for members of these credit unions is that their credit union is forced to put more resources in reserve which makes fewer resources available to credit union members as we emerge from the crisis. This hampers the credit unions' ability to improve their members' financial well-being and advance the communities they serve.

Times of crisis are when credit union members need their credit union the most. Otherwise healthy credit unions should not be forced to reserve extra to accommodate rigid statutory and regulatory capital requirements when their capital declines as a result of natural disaster, pandemic or other external crisis; they should be able to continue to serve their members and help them weather the storm. Therefore, we encourage Congress to enact legislation that provides temporary flexibility to NCUA to offer forbearance from prompt corrective action to otherwise healthy credit unions impacted by federally declared emergencies or disasters.

**State of Credit Unions' Diversity, Equity, and Inclusion Journey**
CUNA and our member credit unions are committed to diversity, equity, and inclusion (DEI) in the financial services sector. In line with that commitment, nearly two years ago CUNA's Board of Directors added DEI to the core set of cooperative principles that guide the work of America's credit unions. While DEI is an integral

component of the original cooperative principles, which date back to the mid-19th century, it was deemed so important that it deserves to have separate recognition and a commitment on the part of the credit union movement. The action by CUNA's board elevated DEI as a priority for the movement.

There is still more work to be done. America's credit unions are committed to enhancing DEI in our member-owned, democratically controlled, not-for-profit financial cooperatives. This commitment manifests itself in several ways, including the establishment of the Credit Union DEI Collective[6]—a network of leading credit unions and credit union system partners, including the National Credit Union Administration (NCUA)—which is dedicated to deepening DEI in the credit union movement through networking, and sharing DEI resources and learning opportunities; a large and growing number of educational opportunities to support credit unions on their DEI journey such as CUNA's annual DEI eSchool, frequent, webinars and conferences focused on DEI in financial services and DEI keynotes and breakout sessions at significant credit union conferences and events. Significantly, the NCUA held its first DEI summit, which was attended by approximately 150 credit unions in 2019 and is planning a second (virtual) summit this year.

In the vein of "you can't improve what you don't measure," credit unions have undertaken research efforts to establish a baseline and measure the impact of changes in diversity, equity, and inclusion at credit unions. Specifically, CUNA recently released research that examines gender diversity in credit union leadership[7]. We are encouraged that our research finds that credit unions lead the way when it comes to women in leadership. We find that 51% of credit union CEOs are women (compared to 3% at banks) and 33% of credit union board members are women (compared to 16% at banks).

In addition, CUNA conducted research examining branch location because it is critical for financial access and inclusion for underserved and historically marginalized groups. We find that 75% of credit union branches are in middle, moderate, and low-income communities (compared to 70% of banks) and 76% of credit union branches are in racially and ethnically diverse areas (compared to 71% of banks).

CUNA's 2019 Annual Member Survey asked credit union CEOs whether they agree that the race and ethnicity of their staff reflects their field of membership. The large majority (64%) agree that their staff reflects their field of membership. Representation matters when it comes to serving an increasingly diverse membership. We acknowledge that we must do better.

Finally, the Filene Research Institute recently launched an important survey focused on credit unions' DEI policies.[8] The goal is to measure the baseline and use this data to help enhance their credit union's DEI efforts and performance.

There is undeniable momentum and energy around our DEI journey in the credit union movement. Credit unions understand that deepening DEI aligns with our mission and makes good business sense. Credit unions are committed to doing more to advance DEI and enhance the financial well-being of our employees, our members, and our communities.

[6] *CU DEI Collective*, https://www.cudeicollective.org/
[7] CUNA, "Women in credit union leadership," Available at: https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/WomenInLeadership_IssueBrief.pdf
[8] Filene Research Institute, "DEI Practices and Policies Survey," available at: https://filene.org/deisurvey-landing

**National Credit Union Share Insurance Fund**
The National Credit Union Share Insurance Fund (NCUSIF) remains strong. The fund's pre-pandemic equity ratio stood at 1.35% and finished 2020 at a historically robust 1.26% reading despite massive fiscal stimulus that led to an enormous 20% surge in insured shares during the year.[9] The credit union 1% deposit true-up in the first quarter of 2021 appears to have pushed the fund ratio back above 1.30%.

There was only one credit union failure in 2020 – and the system's asset quality metrics – both loan delinquency and net charge-off rates – remain near modern-day lows.

Given the health of the fund and its historically favorable performance, we are troubled by the remarks of several NCUA officials, including Chairman Harper, suggesting that NCUA may need to charge a NCUSIF premium in the near future and advocating for statutory changes to the NCUSIF funding guidelines and normal operating level. The Federal Credit Union (FCU) Act currently provides that the NCUA Board may assess a premium charge only if the NCUSIF's equity ratio is less than 1.30 percent and the premium charge does not exceed the amount necessary to restore the equity ratio to 1.30 percent.[10] This process has served the NCUSIF and the credit union industry well. While there is a statutory process in place to ensure the Fund is restored if it drops below 1.20 percent, the boards over the years have been able to actively manage the Fund to maintain it near or above 1.30 percent.[11]

In a letter to Senate Banking Committee Ranking Member Pat Toomey, Chairman Harper called on Congress to enact legislation that:

- Increases the NCUSIF's capacity by removing the 1.5 percent statutory ceiling on the normal operating level.
- Removes the interim limitation on assessing premiums when the equity ratio exceeds 1.3 percent, granting the NCUA Board discretion on the assessment of premiums.
- Provides the NCUA Board with the option to use risk-based premiums and use total assets as the assessment basis, not insured shares.[12]

This is truly a solution in search of a problem. Such a drastic, unnecessary approach is wholly inappropriate because there is no apparent problem with the NCUSIF that is begging to be fixed, the historical performance of the NCUSIF relative to the bank insurance fund is very favorable, and the NCUA Board has at its disposal the tools it needs to properly maintain the NCUSIF.

The NCUSIF is maintained in a relatively straightforward manner: as prescribed by the FCU Act, the NCUA Board has the authority to assess a premium on insured credit unions if, and only if, the equity ratio of the Fund drops below 1.30 percent. This is the tool the NCUA has used to maintain the equity ratio of the Fund at least 1.30 percent. This tool has consistently proven effective in ensuring the equity ratio does not drop, or remain below, the statutorily established 1.30 percent mark.

History shows that the incentives faced by credit union management—generally uncompensated volunteer boards, the absence of stock options for senior management and board members, the absence of pressure from stockholders to maximize profits, and "low-powered" compensation packages— induce management to eschew higher-risk,

[9] https://www.ncua.gov/files/agenda-items/AG20210218Item1a.pdf
[10] 12 CFR § 741.4(d)(2)(i).
[11] 12 CFR § 741.4(d)(2)(ii).
[12] Letter from NCUA Chairman Todd Harper to Senate Banking Committee Ranking Member Pat Toomey, at 4 (Mar. 19, 2021).

higher-return strategies.[13] As a result, credit union operations are less risky and subject to far less volatility over the business cycle. Compared to credit unions, more and substantially larger banks fail during significant economic dislocations. Twice in recent history, the bank insurance fund has operated in the red – while the credit union insurance fund has maintained a steady balance – above 1.20% even in difficult economic times.

While it is true that the NCUSIF has charged premiums to maintain that record, it is also true that since 1990 the FDIC has charged premiums in 21 years – while the NCUSIF has charged premiums in just four years. The NCUSIF has had comparatively little trouble collecting those premiums.

Similarly, it is true that the Great Recession provided significant challenges, but it is also true that those challenges were dominated by corporate credit union failures. The corporate system has been completely and forever changed to ensure that the fund has virtually no exposure to those institutions in the future. The agency must resist the temptation to manage to the last crisis.

Speaking of the Great Recession and its aftermath, it's important to recall that FDIC performance would have been immeasurably worse were in not for nearly $250 billion in direct taxpayer subsidies funneled to the banking industry.

The NCUSIF, of course, is funded by credit union member deposits, so every dollar over-insuring the fund is a dollar that is not being used to the benefit of credit union members. Which means that an over-insured fund idles enormous credit union member benefits. Every ten-basis point increase in the fund ratio represents $1.1 billion taken out of members' pockets—resulting in fewer financial benefits, reduced access (including branching), and a disincentive to encourage and cultivate consultative behaviors that improve consumer financial well-being. Of course, policy makers outside the agency are increasingly demanding more of—not less of—these activities and behaviors.

For these reasons, we find Chairman Harper's advocacy of changes to the NCUSIF unwarranted and counterproductive. Credit union members need their credit unions in the market working to improve their financial well-being and advancing the communities that they serve. Making the changes Chairman Harper proposes would take money out of credit union members' accounts to over-insure a fund that historically has performed its function very well.

**Charter Enhancement Legislation**
In addition to the legislation identified in the appendix of the hearing memo, Congress should consider other changes to the Federal Credit Union Act, which was last substantially updated in 1998. Since then, the financial services sector has changed significantly, but the Federal Credit Union Act and its implementing regulations have not kept pace with technology and how consumers access financial services.
In addition to the enhancements being considered by the Committee today, we support and continue to advocate for:

*Eliminating outdated restrictions on lending maturity limits*
Except for mortgage lending, federally-chartered credit unions are prohibited by statute from making loans with maturity limits in excess of 15 years. Only Oklahoma has a similar constraint on state-chartered credit unions and no such constraint exists for banks. That said, CUNA strongly supports S. 762, the Expanding Access to Lending

[13] Edward Kane, *The Federal Deposit Insurance Fund That Didn't Put A Bite on U.S. Tax Payers*, NBER Working Papers From National Bureau of Econ. Research, Inc. *available here:* https://econpapers.repec.org/paper/nbrnberwo/4648.htm

Options Act, authored by Senators Scott (R-SC) and Cortez Masto (D-NV) which would raise federal credit union loan maturity limits on non-mortgage loans from 15 to 20 years.

One area that this change may impact is student lending, the ability to set a longer loan maturity for federal credit union loans would provide student borrowers across the country with more opportunities for education that is more affordable both in the short and long term. Credit unions would also be able to better service loans for the agricultural sector and other businesses.

*Permitting credit unions to establish their own fiscal year*
Federal credit unions, like other corporations, should have the choice to establish a fiscal year that makes sense as it relates to the members it serves. For example, a credit union may conduct a significant amount of business with members that have seasonal operations. Thus, that credit union may want to have their fiscal year end when that large wave of financial activity is completed.

*Enhancing flexibility of federal credit unions to schedule board meetings*
Under current law a credit union board of directors is required to meet monthly. Federal credit unions should have the authority, as do other corporations, to set meetings through their bylaws.

*Removing outdated responsibilities of boards of directors*
The Federal Credit Union Act requires its board of directors to review membership applications as well as the hiring of loan officers and employees. These responsibilities are undertaken in the daily operation of the credit union by management staff and are unnecessary and burdensome for a board of directors.

*Eliminating the requirement to file certain information regarding loan officers*
Federal credit unions are required to file with NCUA the names and addresses of executive officers, supervisory committee members, credit committee members, and loan officers. That information should be accessible through the credit union management and is unnecessary.

*Ensure credit unions the ability to better protect members and employees*
Although extremely rare, some credit union members may engage in sometimes dangerous or illegal conduct. This can include physical damage to property, harassment, threats, or fraud. Under current law, a 2/3rds vote of the full credit union membership is required to expel a member. In these cases, the time and resources required for a full vote are simply not practically effective. As such, CUNA supports H.R. 2311, the Credit Union Governance Modernization Act, authored by Reps. Emmer (R-MN) and Perlmutter (D-CO), which would amend the Federal Credit Union Act to afford a more efficient process by requiring a majority vote of the board of directors of a credit union while at the same time providing a robust appeal process for the credit union member.

**Banks Selling to Credit Unions**
Recently, the American Bankers Association (ABA) and other bank groups have become concerned with the relatively rare phenomenon of their member-banks choosing to sell assets to credit unions when they make a business decision to leave a market. The position that these organizations have taken is perplexing on many levels.

In the first place, we question the long-term viability of membership organizations that openly oppose the ability of their members to make business decisions in the interest of their stakeholders. When a for-profit bank is ready to exit a market, its management has a fiduciary duty to seek the best deal for their shareholders. The opposition by the bank trade groups to their member banks selling to credit unions undermines that fiduciary responsibility.

Secondly, we don't quite know what to make of the bank groups' objection to these transactions given the relative size of this activity. Since 2012, there have been 39 bank sales to credit unions (totaling $6.2 billion) compared to more than 2,000 bank to bank merger and acquisitions (totaling $2.0 trillion); market-based sales to credit unions represent roughly 0.3% of the total asset volume of all bank merger activity during this time period.[14] To say they are making a mountain out of a molehill would be grossly exaggerating the size of a molehill.

Nevertheless, if the bank trades want to shine light on bank consolidation, the abandonment of communities and the creation of banking deserts in the interest of shareholder profit, who are we stop them? We welcome that conversation.

The bank groups say that these deals are a bad deal for taxpayers, a bad deal for low-income communities, a bad deal for consumers, and a bad deal for credit unions and "the credit union idea." We respectfully and strenuously disagree, and we will address their concerns in order.

The bank trade groups are very concerned about the government getting tax revenue, but they conveniently leave out the part where they saw their federal tax burden reduced by roughly $30 billion annually a few years ago.

They also leave out the part about the large percentage of these banks often pay no taxes in the year prior to their sale to a credit union, according to call report filings. Among the 39 bank sales to credit unions since 2012, at least 16 banks reported no applicable income taxes in the calendar year prior to the deal, with a zero percent median effective tax rate (federal and state) for all bank sales transactions in the year prior to sale.

Further, the bank groups conveniently ignore the fact that when a bank sells to a credit union, the bank is subject to capital gains taxes for all of the shareholders, and the credit union is subject to the same employment and state taxes that all credit unions pay. In 2020, banks involved in sales to credit unions reported $267,000 in applicable taxes in the previous year while more than $65 million was paid in taxes on capital gains associated with these transactions.

The second concern the bank groups raise involves the effect these transactions have on communities. While it is well established that bank consolidation can adversely impact communities, these transactions are good for the local communities.

Since 2004, banks have shuttered a net of more than 6,000 branches, creating at least 86 banking deserts. In the same period, credit unions have opened a net 1,600 branches. Regardless of whether it is another credit union or a bank selling its assets, commitment to the community remains the core of the credit union mission; branches stay open.

Furthermore, 80% of these bank-to-credit union transactions have involved low-income designated credit unions – which means that, generally speaking, these are credit unions with more than half of their members having incomes below 80% of the local median income. When a bank sells to a credit union, it is very likely that the bank facilities will continue to serve the community and that the credit union is one that has a particular focus on low-income individuals and families.

A report published by Federal Reserve Bank of St. Louis notes that credit unions can be seen as "preferable suitors" for many banks because: "small community banks tend to have deep ties to their customers and take pride in fostering their communities' growth and financial security. Other things equal, the owners of these banks might

[14] CUNA, "Bank Sales to Credit Unions," February 2021, *available here:* https://www.cuna.org/uploadedFiles/Global/About_Credit_Unions/Bank%20Sales%20Issue%20Brief%202021.02.20.pdf

prefer to sell to an organization that has similar customer-oriented values. That is, they might feel that they have more in common with the culture at a neighborhood credit union than with the culture of a distant large bank."[15] When a bank sells to a credit union, the community is the winner: a potential banking desert is prevented, and the community continues to receive locally provided financial services but now in the form of a member-owned credit union.

Third, the bank groups claim this is a bad deal for consumers. This is a claim that is hard to believe both in general and with respect to the bank-to-credit union transactions.

In general, consumers – both credit union members and bank customers – routinely say that credit unions are more consumer-friendly, more trustworthy and an overall better value than banks. For example:

- A recent Morning Consult study found consumers are twice as likely to "agree strongly" that credit unions "act in consumers' best interests and are good corporate citizens" compared to the same answer about banks.[16]
- Gallup research finds that "credit unions have built strong member relationships by using a personal approach, thoughtful products and member-centric service models to help members manage their finances." Nearly half — 46% of members — "strongly agree" with this statement about their credit union, while less than one-third (only 31%) of bank customers feel similarly.[17]
- Consumer Reports states: "Credit unions are among the highest-rated services we've ever evaluated, with 96 percent of our members highly satisfied…that satisfaction is driven by good customer service, not surprising when you consider that credit unions are owned and managed by their members."[18]
- CFI Group reported their Credit Union Satisfaction Index stood at 86 in 2018 — well above the Bank Satisfaction Index which finished the year at 80.[19]

Bank-to-credit union transactions provide a terrific example of the differential impact of credit unions versus banks. We estimate that since 2012, there have been 211,000 new members added to credit unions through bank sales. In the last calendar year alone, these members have accrued a financial benefit of roughly $31 million because they are credit union members, not bank customers. This is accomplished through profits being returned to credit union members in the form of higher savings yields, lower fees, and lower loan interest charges, and the retention of the money in local economies.

Contrast that outcome to what happens when a big bank acquires a community bank. In those cases – which sadly represent the vast majority of merger and acquisition activity – the profits are often syphoned to the mothership in San Francisco, New York and Charlotte. Recent literature is replete with references to big banks purchasing smaller institutions, cherry-picking the branch networks and then closing those that don't meet stringent profit criteria.[20] Without question, when a bank sells to a credit union, its customers are the big winners.

It is amusing that the bank trade groups feign concern for the impact these transactions have on credit unions. Rest assured: just as bank sales to credit unions are good for the bankers who are selling, the community that retains

[15] Meyer, Andrew P. St. Louis Federal Reserve. "Why Are More Credit Unions Buying Community Banks?" Regional Economist. April 2019.
[16] CUNA-commission Morning Consult National Tracking Poll of 2,200 U.S. adults. January 2020.
[17] Gallup. https://www.gallup.com/workplace/268220/credit-unions-banks-financial-wellbeing-proposition.aspx
[18] Consumer Reports. March 23, 2018. https://www.consumerreports.org/banks/best-and-worst-banks-and-credit-unions/
[19] CFI Group. 2018. www.cfigroup.com.
[20] See for example: Ensign, Rexrode, Jones. "Banks Shutter 1,700 Branches in Fastest Decline on Record," Wall Street Journal. February 5, 2018.

local-service, and the customers who get access to the benefits of credit union membership, so too are these transactions good for credit unions. When a bank sells to a credit union, it gives the credit union an opportunity to grow, expand service offerings and leverage synergies like cultural alignment. Further, research conducted by the Filene Research Institute shows that since 2012, credit unions involved in bank sale transactions have reflected greater financial stability and thus higher safety and soundness than other institutions.[21]

Finally, we would be remiss if we did not point out the bank groups' disingenuous concern for the impact these transactions have on the "credit union idea." For nearly 100 years, no group has more fiercely opposed the "credit union idea" than the American Bankers Association. But, their propaganda and talking points have not changed since the 1930s, when Congress entrusted credit unions to help earners rebuild amid the Great Depression.

The bank trades would have Congress forget what they conveniently ignore: credit unions exist for a purpose spelled out in statute – to promote thrift and provide access to credit for provident purposes. Credit unions were established as not-for-profit financial cooperatives to meet the needs of consumers, small businesses and communities that were not being served by commercial banks and that were being taken advantage of by usurious payday lenders. These problems continue today, but to a smaller extent than they otherwise would because credit unions compete in the market and consumers choose credit unions. When a bank sells to a credit union, it doesn't undermine the "credit union idea," it reinforces it – to almost everyone's benefit.

It is important to recognize there is one group that doesn't benefit from these transactions: bank groups, like the ABA and its cohorts. When a bank sells to a credit union, these groups lose a member. On balance, however, that seems inconsequential when you consider that these transactions are good for the bank shareholders; they are good for the bank customers; they are good for the credit unions; they are good for the community; they enhance credit union safety and soundness; and they are consistent with credit unions' Congressional mandate.

We encourage Congress to dismiss the bank groups' concern over their member-banks selling to credit unions.

**Conclusion**
On behalf of America's credit unions and their more than 120 million members, thank you for holding this hearing and considering our views.

Sincerely,

Jim Nussle
President & CEO

[21] Walker, David A. and Largay, John A. Credit Unions' Acquisitions of Banks and Thrifts. Filene Research Institute. June 2018. Also see:
https://podcasts.apple.com/us/podcast/filene-research-institute/id1124551986?i=1000413067117

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NAFCU
National Association of Federally-Insured Credit Unions

May 17, 2021

| | |
|---|---|
| The Honorable Maxine Waters | The Honorable Patrick McHenry |
| Chairwoman | Ranking Member |
| Committee on Financial Services | Committee on Financial Services |
| U.S. House of Representatives | U.S. House of Representatives |
| Washington, D.C. 20515 | Washington, D.C. 20515 |

**Re: Oversight of Prudential Regulators Hearing**

Dear Chairwoman Waters and Ranking Member McHenry:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing to share NAFCU's perspective on the issues before the Committee as part of Wednesday's hearing on the Oversight of Prudential Regulators. We thank you for your continued focus on oversight of the National Credit Union Administration (NCUA) and other prudential regulators. As the Committee carries out its oversight functions, we urge you to keep our concerns on these key issues in mind.

**NAFCU Opposes Granting NCUA Oversight Authority Over Third-Party Vendors**

NAFCU is opposed to the discussion draft of the "NCUA Oversight of Third Party Vendors Act" that has been proposed as part of the hearing. NAFCU and our member credit unions believe that cybersecurity, including the security of vendors that credit unions do business with, is an important issue. However, we are opposed to granting additional authority to NCUA to examine third parties at this time. NAFCU believes in a strong NCUA, but we also believe that the NCUA should stay focused on where their expertise lies—regulating credit unions. Credit unions fund the NCUA budget. Implementing such new authority for NCUA would require significant expenditures by the agency. The history of NCUA's budget growth has shown that these costs would ultimately be borne by credit unions and their members.

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 NCUA sits on the Federal Financial Institutions Examination Council (FFIEC) with the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and the Federal Reserve. The FFIEC was created to coordinate examination findings and approach in the name of consistency and to avoid duplication. This means that as a member of the FFIEC, NCUA should be able to request the results of an examination of a core processor from the other regulators and not have to send another exam team from NCUA into their business and duplicate an examination. This would seem to be an unnecessary burden on these small businesses. Additionally, if NCUA did its own examination, the likelihood of finding anything the other regulators did not would seem to be close to nil.

Instead of granting NCUA vendor examination authority, Congress should encourage the agency to use the FFIEC and gain access to the information on exam findings on companies that have already been examined by other regulators. This would address NCUA's concerns without creating additional costs to credit unions and increasing regulatory burdens on credit unions and small businesses. It would seem to be one way to address the issue without creating new regulatory and cost burdens on credit unions. As such, we urge the Committee to reject this draft legislation.

**The National Credit Union Share Insurance Fund (SIF)**
While NAFCU applauds NCUA Chairman Todd Harper, the NCUA Board and the agency's leadership for their prudent oversight of the SIF during the pandemic, we do not think changes to the structure of the SIF or a premium charge on credit unions are warranted at this time. The fact that the SIF has fared so well during the past 12 months provides ample evidence that the fund is strong and that credit unions were well-capitalized and had strong balance sheets entering the crisis. This provided them with the necessary scope to extend assistance to their members during the pandemic. The current language of the *Federal Credit Union Act* (FCU Act) creates this strong insurance fund for credit unions.

The FCU Act creates a SIF that is structured fundamentally differently than the Deposit Insurance Fund (DIF) run by the FDIC. NAFCU is opposed to any efforts that call for legislative changes to the FCU Act to give NCUA the powers to manage the SIF similar to the DIF, such as allowing new premium assessments when they are not needed, removing upper limits on the normal operating level, or making changes that threaten the mutual nature of the fund. The FCU Act recognizes the importance of not hitting credit unions and their members with an unnecessary premium through very specific language that gives the NCUA an eight-year (or longer) window to restore the SIF equity ratio to 1.2 percent should it fall below that level. We caution against any calls for statutory changes to the SIF that go against the spirit of this provision in the Act—a provision that is designed not only to keep credit unions healthy, but also to keep funds available to credit union members.

**The Durbin Amendment**
NAFCU opposes any effort to extend debit interchange price caps or routing requirements to credit cards. Since the passage of the Durbin amendment on debit interchange rates in the *Dodd-Frank Act*, the retail industry has not followed through on their promise to pass on interchange fee savings to their customers. Now they are asking for the same failed policies to be extended or expanded. This would cause irreparable harm to credit unions and could damage the availability of credit to consumers. The electronic payments system is a two-sided market, with consumers on one side and merchants on the other. Both sides benefit from the arrangement, with card networks setting interchange rates based on the cost of doing business, and the benefit to consumers and merchants. The credit card system allows consumers to purchase goods and services from merchants that they may not be able to otherwise. The pandemic provided even more evidence that the electronic payments system offers real value to merchants and consumers alike. Ultimately, merchants receive far more value from accepting electronic payments than they pay in interchange fees. Any new caps or requirements impacting interchange fees would only hurt community institutions such as credit unions and the American consumer.

**NAFCU Supports the "Expanding Financial Access for Underserved Communities Act"**

NAFCU supports the discussion draft of the "Expanding Financial Access for Underserved Communities Act" which would expand the ability of credit unions to add underserved areas to their field of membership (FOM). In 1998, as part of the *Credit Union Membership Access Act*, Congress provided federal credit unions with the ability to add underserved areas to their FOM. However, subsequent legal challenges by the banking industry over the reading of the statute led the NCUA to limit this authority to only multiple common bond credit unions in 2006.

As Congress grapples with ways to ensure that underserved and unbanked populations have access to affordable financial services, credit unions want to be able to help. Unfortunately, many credit unions are limited by the restriction on adding underserved areas to their FOM. One area where this legislation would be extremely helpful is in rural areas. According to a recent report by the Federal Reserve, between 2012-2019 credit unions grew their branch presence in rural areas by 2%, while community banks decreased rural branches by 5% and large banks decreased rural branches by 19%. Credit unions are proud to be at the forefront of efforts to expand financial services access to rural areas, many of which are underserved, and want to do more. However, not all credit unions can add underserved areas to their field of membership, making it challenging for some to expand in rural areas. We urge the Committee to support this draft legislation that would allow all types of credit unions to add underserved areas and make it easier to make critical member business loans to small businesses in those areas.

**H.J. Res. 35, Resolution of Disapproval on the OCC's "True Lender" Rule**

NAFCU supports H.J.Res.35, which would repeal the rule submitted by the OCC relating to "National Banks and Federal Savings Associations as Lenders" (the "True Lender rule"). The OCC finalized its True Lender rule in October 2020, which became effective in December 2020, allowing banks and federal savings and loans to provide their charter for online lenders to deliver high-cost loans with annual rates exceeding 100 percent that evade state consumer protections and usury caps. In this scheme also known as "rent-a-bank," online lenders essentially rent bank charters and documentation to originate their loans in the name of the OCC-chartered banking institution, arguing that it is now a "bank loan" exempt from state rate caps.

These predatory payday lenders are operating on an uneven playing field, relying upon the benefits of the OCC's federal preemption to circumvent consumer protections and place borrowers in harms' way. What is most concerning is the lasting damage this form of wealth extraction has on household financial security and on communities. Given the damage caused by these high-cost, unaffordable loans to borrowers' balance sheets, it limits the ability for legitimate and responsible lenders to support those households and communities with productive credit.

Credit unions have been on the frontlines during the pandemic, working to ensure their members stay afloat financially with consumer-friendly financial products. Credit unions have voluntarily implemented programs to protect their members' financial health, including skipping payments without penalty, waiving fees, low or no-interest loans, loan modifications and no interest accruals. Moreover, credit unions are able to meet their members' demands for short-term, small dollar loans, while ensuring accessibility, safety, and affordability. Oftentimes, credit unions offer short-term, small-dollar loans as a service to members with the associated fees solely covering the expenses of loan servicing.

The FCU Act establishes an interest rate ceiling cap of 15 percent on loans and provides the NCUA with flexibility to establish a higher interest rate for up to 18 months after considering certain statutory criteria. The current interest rate is set at 18 percent and has been in place since 1987. The NCUA has authorized a program referred to as payday alternative loans (PALs) to enable credit unions to offer their members a reasonable alternative to high-cost payday loans. The FCU Act establishes the interest rate ceiling for PALs at an additional 1000 basis points above the prevailing interest rate, so the current maximum allowable interest rate for a PAL is 28 percent. This maximum interest rate is far from the exorbitant interest rates charged by payday lenders and provides a safe, affordable option for consumers in need of a quick, short-term, small-dollar loan. The Consumer Financial Protection Bureau (CFPB) and CFPB Director-nominee Rohit Chopra have previously recognized the benefit credit union PALs provide to their communities.

Rather than pursuing problematic options like the OCC's True Lender rule to increase access to credit, we would suggest Congress consider consumer-friendly alternatives such as expanding credit unions' ability to offer PALs. Too many Americans are unbanked, underbanked, or underserved by financial institutions, and do not have the access that they need to financial services. Credit unions stand ready to help with financial literacy education and access to loans and other financial products, including PALs, but many are limited in their ability to add underserved areas to their fields of membership. Allowing all credit unions to add underserved areas to their fields of membership is one way to help those who need it most have access to capital without burdening the federal government. This request has bipartisan NCUA Board support.

At a time when low-income consumers can least afford it, the OCC's rule is enabling high-cost lenders to prey on consumers that are on even more precarious financial footing, which could threaten COVID-19 economic recovery efforts and the good work of consumer-friendly financial institutions like credit unions. We urge you to support H.J.Res.35 to overturn the True Lender rule and stop this harmful practice.

**Fintech Charters**

Fintech companies are enjoying unprecedented liberalization of bank chartering rules to either acquire or become banks. Recent developments with both the OCC's new chartering options and the FDIC's approval of deposit insurance for Industrial Loan Company (ILC) applicants also present problems. In each case, a nonbank company can potentially evade regulation under the *Bank Holding Company Act* (BHCA), either because of a statutory loophole unique to ILCs, or because the entity does not accept deposits. Lack of BHCA coverage raises serious concerns regarding the quality and extent of supervision for these specialized or limited purpose banking entities. Chartering additional ILCs or granting new licenses to payments companies could also weaken the safety and soundness of the wider financial system.

In certain cases, specialized, limited purpose bank charters may allow a fintech to operate with national bank privileges but without the same prudential safeguards that apply to traditional banks and credit unions. While some may characterize these chartering schemes as innovative, they are ultimately loopholes which invite unnecessary risk into the financial system and create an uneven playing field. As NAFCU has previously communicated to the Committee, we support efforts to ensure that these new entities have oversight and are properly regulated so that they compete on a level playing field with other regulated institutions.

**NAFCU Supports Making Central Liquidity Facility (CLF) Changes Permanent**
We would also like to express our support for the "Central Liquidity Facility Enhancement Act" which would make the important changes to the CLF made during the pandemic permanent to better serve credit unions moving forward. Taking this step now will help ensure that NCUA has a critical tool to help credit unions the next time financial uncertainty arises.

**Other Draft Legislation Before the Committee**
NAFCU also supports efforts to promote new credit unions, and we urge support for the discussion draft of the "Promoting New and Diverse Depository Institutions Act" which would take important steps to help promote de novo institutions by studying the challenges facing these institutions and having regulators develop a strategic plan to meet those challenges.

We also support the goal of the draft "Expanding Opportunities in Banking Act" which would allow the opportunity for those convicted of certain minor offenses to work in financial services and would note that this was an initiative of NCUA Board Member Rodney Hood when he served as Board Chairman.

Thank you for the opportunity to share our thoughts on the range of issues before the Committee at this hearing. Should you have any questions or require additional information, please do not hesitate to contact me or Sarah Jacobs, NAFCU's Associate Director of Legislative Affairs, at (571) 289-7550 or sjacobs@nafcu.org.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Committee on Financial Services

National Credit Union Administration

**United States House Committee on Financial Services**
**Full Committee Hearing: "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"**
**Wednesday, May 19, 2021**

**Responses to the Questions for the Record**

**Questions for The Honorable Todd M. Harper, Chairman, National Credit Union Administration, from Congresswoman Joyce Beatty:**

*1) This question is for the panel.*

*On January 20, 2021, President Joe Biden signed an executive order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government which directs the heads of federal Agencies, in consultation with the Director of the Office of Management and Budget, to conduct a review of certain programs and services to assess whether underserved communities and their members face systemic barriers in accessing benefits and opportunities available pursuant to those policies and programs.*

*Do you believe your Agency is covered under the ongoing review, and if not, to what extent has your Agency considered conducting a racial equity audit to determine the extent to which the Agency's policies and practices may contribute to systemic barriers that impede women and people of color within your workforce, via procurement opportunities for Minority- and Women-Owned Businesses (MWOBs) and via the elimination of such barriers through the oversight and examination of regulated entities?*

***Response:***

The NCUA is an independent federal agency and, as such, is not covered under the Executive Order or the ongoing review. However, in appropriate circumstances, the NCUA may choose to voluntarily comply with the spirit of certain Executive Orders. To date, the NCUA has relied on the annual Management Directive 715 (MD-715) report to the Equal Employment Opportunity Commission to identify triggers that indicate barriers that might impede women and people of color. The NCUA's Office of Minority and Women Inclusion (OMWI) also tracks workforce trends and applicant flow in the yearly State of the Agency briefing to the members of the NCUA Board. The agency provides workforce trend data for both gender and race categories as part of its OMWI Annual Report to Congress.[1]

Over the past few years, the NCUA has worked with the Office of Personnel Management to analyze perceived disparities found in the Principal Examiner Exam passing rates between certain groups—namely when comparing White examiners' passing rates to those of Black/African American and Hispanic examiners. Based on this analysis, the NCUA has

[1] *See:* https://www.ncua.gov/files/publications/2020-omwi-congressional-report.pdf

developed a series of short- and long-term strategies and resources that directly address the perceived preparation barriers to create more consistent and equitable developmental opportunities for all examiner groups.

Following OMWI's establishment in 2011, the agency assessed its supplier diversity statistics, as well as its procurement policies and practices. Ultimately, the assessment gave way to a series of changes in procurement policies and practices that drove an increase in the agency's percentage of contract dollars with minority- and women-owned businesses from 6 percent in 2010 to a high of 45 percent in 2018. In 2019 this decreased to 43.0 percent and further decreased in 2020 to 33.2 percent. The percentages fell in 2019 and 2020 due to the completion of office renovations at the NCUA's headquarters location. This resulted in a substantial decrease in nonrecurring obligations in the 2020 contract award held by a minority-owned facilities maintenance contractor.

OMWI analyzes and reports on its diversity spending annually on both overall contracting with minority- and women-owned businesses, and contracting by racial category, as part of its OMWI Annual Report to Congress. Additionally, the agency continuously monitors adherence to the procurement policies and practices that promote the inclusion of minority- and women-owned businesses.

*2) This question is for the panel.*

*On April 20, 2021, the House Financial Services Committee passed HR 2123 the "Diversity and Inclusion, Data Accountability and Transparency Act" which would amend Section 342 of the "Dodd Frank Wall Street Reform and Consumer Protection Act" to make the sharing of diversity performance data of regulated entities with the Offices of Minority and Women Inclusion mandatory.*

*On an annual basis, covering years 2016 to the present, what percentage of covered entities invited to submit a self-assessment of their diversity and inclusion performance data have provided such data? On an annual basis covering years 2016 to the present, what percentage of entities regulated by the industry were invited to provide a self-assessment of their diversity and inclusion performance data? How has the response rate of covered entities to the self-assessment requests impacted your Agency's ability to develop comprehensive, aggregated benchmarks of diversity and inclusion performance among entities regulated by the Agency?*

***Response:***

On an annual basis covering years 2016 to the present, 100 percent of Federally insured credit unions regulated by the NCUA were invited to provide a self-assessment of their diversity and inclusion performance data.[23]

[2] *See:* https://www.ncua.gov/about/diversity-inclusion/credit-union-diversity/voluntary-credit-union-diversity-self-assessment

[3] *See:* https://www.ncua.gov/about-ncua/diversity-inclusion/credit-union-diversity/credit-union-diversity-standards

However, with a population of 5,099 federally insured credit unions (as of year-end 2020) and a response rate of only 188, the NCUA is unable to generate an accurate and representative benchmark of diversity and inclusion performance for the credit union industry. On average, for a population of 5,000, the agency would need approximately 910 respondents to achieve a +/- 3 percent margin of error, and 370 respondents for a margin of error of +/-5 percent.

The below chart does show the response rate is increasing each year.

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| **# of CUs submitting** | 35 | 64 | 81 | 118 | 188 |
| **# of CUs invited** | 5785 | 5573 | 5375 | 5236 | 5099 |
| **% of CUs submitting** | 0.6% | 1.1% | 1.5% | 2.3% | 3.7% |
| **Year-over-Year Response Increase** | | 82.9% | 26.6% | 45.7% | 59.3% |

The NCUA is dedicated to continuing efforts to encourage even more credit unions to participate in the self-assessment process. The NCUA communicates this through speeches, newsletters, forums, press releases, webinars, and on postings to the NCUA website. With the information received, the agency shares best practices with credit unions, resulting in positive business outcomes.

August 20, 2021

**Answers to Questions for the Record Following a Hearing on "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions" Conducted by the U.S. House Committee on Financial Services**

On May 19, 2021, the U.S. House Committee on Financial Services convened a hearing at which Michael J. Hsu, Acting Comptroller of the Currency, testified on "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions." After the hearing, members of the Committee submitted questions for the record. This document provides the Office of the Comptroller of the Currency's answers.

**Rep. Beatty**

On January 20, 2021, President Joe Biden signed an executive order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government which directs the heads of federal Agencies, in consultation with the Director of the Office of Management and Budget, to conduct a review of certain programs and services to assess whether underserved communities and their members face systemic barriers in accessing benefits and opportunities available pursuant to those policies and programs.

**Question 1:** Do you believe your Agency is covered under the ongoing review, and if not, to what extent has your Agency considered conducting a racial equity audit to determine the extent to which the Agency's policies and practices may contribute to systemic barriers that impede women and people of color within your workforce, via procurement opportunities for Minority- and Women-Owned Businesses (MWOBs) and via the elimination of such barriers through the oversight and examination of regulated entities?

**Response:** While the OCC, as an independent regulatory agency, is not subject to Executive Order 13985, the agency regularly monitors its procurement activities to ensure that we maximize the participation of small disadvantaged and minority-owned and women-owned businesses. We also routinely analyze our agency workforce demographics as part of our regular annual reviews.

In addition, promoting fairness and inclusion in banking is a fundamental part of the OCC's mission, and reducing banking inequities is one of my top priorities. Our Project REACh (Roundtable for Economic Access and Change) efforts, though not structured as an Executive Order 13985 program, provide the OCC with opportunities to expand underserved communities' access to credit and capital. Four dedicated Project REACh workstreams—focusing on (1) inclusion for credit invisibles, (2) revitalization of Minority Depository Institutions, (3) increasing homeownership and the inventory of affordable housing; and (4) expanding access to capital for minority-owned and small businesses—have made considerable progress. On the recent one-year anniversary of Project REACh, I encouraged the workstream participants at financial institutions to aim even higher and devise "moonshot" goals for the next two years that will motivate and inspire actions and outcomes that will make a difference and be felt in underserved communities.

**Question 2**

On April 20, 2021, the House Financial Services Committee passed HR 2123 the "Diversity and Inclusion, Data Accountability and Transparency Act" which would amend Section 342 of the "Dodd Frank Wall Street Reform and Consumer Protection Act" to make the sharing of diversity performance data of regulated entities with the Offices of Minority and Women Inclusion mandatory.

> **Question A:** On an annual basis covering years 2016 to the present, what percentage of entities regulated by the [agency] were invited to provide a self-assessment of their diversity and inclusion performance data?

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| Total OCC Institutions | 1,429 | 1,347 | 1,264 | 1,200 | 1,220 |
| OCC institutions contacted[1] | 382 | 378 | 211 | 225 | 327 |
| FRB holding companies removed | --- | --- | 154 | 142 | 31 |
| % of total OCC institutions contacted | 26.7% | 28.1% | 16.7% | 18.7% | 26.8% |

**Response**: The data presented in this table reflects the percentage of total OCC institutions that were contacted and invited to submit diversity self-assessments. In 2018, the OCC began removing those Federal Reserve Board (FRB) holding company affiliates with national bank charters from the OCC's list of institutions on diversity self-assessments. (For 2018 and 2019, the OCC removed 154 and 142 institutions, respectively, that received FRB request letters.) In 2020, OCC's OMWI removed 31 FRB holding companies that consistently submitted diversity self-assessments in prior years.

> **Question B**: On an annual basis, covering years 2016 to the present, what percentage of covered entities invited to submit a self-assessment of their diversity and inclusion performance data have provided such data?

[1] In accordance with the *Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Regulated Entities*, the OCC invited institutions with 100 or more employees to submit diversity self-assessments.

| | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|
| OCC institutions contacted[2] | 382 | 378 | 211 | 225 | 327 |
| Total submissions | 56 | 35 | 41 | 22 | 50[3] |
| Response rates | 14.7% | 9.3% | 19.4% | 9.8% | 15.3% |

**Response**: The above table reflects the response rates of OCC institutions that submitted annual diversity self-assessments over the 2016-2020 period. As noted above, in 2018, to prevent repetitive requests to bankers, the OCC began to remove those institutions that were affiliates of holding companies that received diversity self-assessment request letters from the FRB. The OCC obtains copies of relevant diversity self-assessments that are submitted to the FRB.

> **Question C**: How has the response rate of covered entities to the self-assessment requests Impacted your Agency's ability to develop comprehensive, aggregated benchmarks of diversity and inclusion performance among entities regulated by the Agency?

**Response**: The low response rate of voluntary diversity self-assessment submissions does not provide the OCC with an adequate and broadly sufficient baseline from which to develop benchmarks of diversity and inclusion performance. The OCC would be supportive of legislation that advances a mandatory reporting requirement.

However, in an effort to engage with the bankers around diversity, equity and inclusion, the OCC's OMWI Executive Director participated in two interagency Diversity and Inclusion Summits and an American Bankers Association (ABA) webinar. The events enabled the Director to discuss leading practices in diversity and inclusion and directly encourage bankers to submit their diversity self-assessments. Additionally, the Director held one-on-one discussions with the chief diversity officers of two of the OCC's large banks to gain information on their diversity and inclusion performance.

[2] Id.

[3] As of 7/12/2021.

**Rep. Luetkemeyer**

Consumer Data (To Hsu, McWilliams, and Quarles)

It is becoming more and more clear how significant a role "big tech" plays in every aspect of the U.S. economy and how the data they hold brings unimaginable power. It's not a stretch to say that some of the largest technology companies, like Google, Apple, and Amazon, are "too big to fail." Despite this, recent actions by the FDIC, the OCC, the Federal Reserve, and state banking authorities, have made it easier for companies like Google, Apple, and Amazon to access the banking system and expand their data troves to a previously unreachable dataset: consumer financial data.

**Question**: Do you have concerns about big technology firms, and commercial entities more generally, gaining access to consumer financial data without being subject to the same privacy and data security requirements (including examinations) imposed on banks and their parent companies?

**Response**: Yes, I have concerns about the safeguarding of consumers' financial data in today's increasingly complex environment with banks, fintechs and big technology firms all having a role in managing and safeguarding consumers' sensitive information. Where the OCC has authority, it has sought to strengthen data protections through rules, guidance, and supervisory practices. In my testimony, I noted the importance of being able to adapt to the increasing digitalization of banking and finance and my concerns with taking a fragmented agency-by-agency approach to the technology-driven changes taking place today. The OCC implemented enforceable guidelines, pursuant to Title V, Subtitle A, of the Gramm–Leach–Bliley Act (GLBA),[4] requiring banks to establish appropriate administrative, technical, and physical controls for the safeguarding of customer information.[5] CFPB regulations also govern the treatment of nonpublic personal information about consumers.[6]

The OCC actively works with our banking regulatory counterparts to provide supervisory guidance, statements, and other resources for banks and their technology service providers to communicate effective practices for cybersecurity, including the protection of sensitive customer information. The OCC has robust third-party risk management guidance[7] on sound practices for banks' engagement with third parties, such as financial technology firms. This guidance was followed with a Frequently Asked Questions (FAQs) supplement[8] that addresses a number of topics, including privacy and security related issues. An example of this is an FAQ that outlines sounds practices for banks engagement with data aggregation services and third party financial technology firms for the safe and sound sharing customer permissioned information. In order to provide better alignment with the agencies, the OCC, Board of Governors of the Federal Reserve

[4] See 15 USC 6801-6809

[5] See 12 CFR part 30 appendix B

[6] See 12 CFR part 1016.

[7] Third-Party Relationships: Risk Management Guidance | OCC

[8] Third-Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29 | OCC

System (Federal Reserve) and Federal Deposit Insurance Corporation (FDIC) recently published proposed updates to the third-party risk management guidance for joint issuance with a request for public comment.[9]

Another channel for communicating supervisory expectations to technology firms and nonfinancial commercial entities is the OCC's Office of Innovation. The Innovation Office coordinates outreach and engagement with financial technology firms on new or innovative products, services and technologies being considered or implemented in the federal banking system. This will include discussion of issues related to access to bank customers' sensitive information, management and use of this sensitive information, and cybersecurity and safeguarding of bank customers' sensitive information.

In addition to rules, guidance and supervision of banks' third party risk management activities to safeguard sensitive customer information, the OCC coordinates with the Federal Reserve and FDIC for the examination of the most significant service providers to the banking industry under authorities provided by the Bank Service Company Act (12 U.S.C. §1861 *et seq.*). These examinations include assessments of cybersecurity and resilience of the services these organizations provide to banks, including the safeguarding of sensitive customer information.

Cybersecurity Rulemaking (To Hsu, Quarles, McWilliams)

Earlier this year, the Federal Reserve, the OCC, and the FDIC issued proposed rulemaking relating to increased notification standards around what the rule defined as "computer security incidents." With the increased cyber attacks we've seen in the past year, coupled with the dramatic, and necessary, shift to digital and e-commerce solutions for financial institutions in the wake of the COVID-19 pandemic, the intent of this rulemaking is both well timed and valuable to the stability of the system. That said, upon review of the NPR and through discussions with bank service providers and financial institutions alike, it seems that this rulemaking needs further review and amendment before a potential final review.

**Question 1.** Would you be able to provide an update of where this joint rule currently stands? Is it your intent to continue down the rulemaking process and issue a final rule based on the comments received during the NPR?

**Response**: On January 12, 2021, the OCC, Board, and FDIC (the "agencies") issued a notice of proposed rulemaking titled, "Computer-Security Incident Notification." Since the closure of the comment period on April 12, 2021, the agencies have been jointly reviewing and considering the public comments that have been submitted.

**Question 2.** The NPR currently requires any service provider who falls under the BSCA with a requirement to provide immediate notification of a computer security incident that is "believed in good faith could disrupt, degrade, or impair services provided subject to the BSCA for 4 or more hours."

[9] Third-Party Relationships: Notice and Request for Comment on Proposed Interagency Guidance | OCC

**a.** The NPR does not define "disrupt, degrade, or impair" and my office has heard concerns that the ambiguity within this term could lead to both the over notification to financial institutions and from financial institutions to you, the regulators. Simple question – how do each of you define this phrase? Is there a common definition you're using and planning on providing guidance on?

**Response**: The preamble to the proposed rulemaking sought to provide clarity on the meaning of "disrupt, degrade, or impair" by offering a number of examples that the agencies intended to be within the scope of the rulemaking. The agencies also specifically requested comment on this language in the proposal. The agencies are currently reviewing the comments to determine whether changes or clarifications would be beneficial in any final rule.

**b.** Additionally, as written, this rule does not exempt or exclude scheduled maintenance or other planned outages that will inevitably "disrupt, degrade, or impair" as a requirement of updating, servicing, or improving services. Is it your intent to have service providers notify banks of these scheduled maintenance periods?

**Response**: The agencies have received comments raising the issue of scheduled maintenance or other planned outages as they relate to bank service provider obligations in the proposed rule. The agencies are reviewing those comments to consider responsive changes in any final rule.

**Question 3**. Most community financial institutions partner with multiple service providers who fall under the BSCA. And most service providers support multiple financial institutions who will have reporting requirements under this NPR. How do you anticipate preventing notification fatigue – the over notification of non-material issues by service providers – and over reporting to the regulator?

**Response**: The OCC believes that it is important for any notification obligation to appropriately balance the risks of over and under notification. In support of that balance, the proposed rule is limited in scope to address significant computer-security incidents. The agencies received comments on this point, and will consider whether changes are needed to achieve an appropriate balance in any final rule.

**Question**: What assurances can you provide to community banks that annual examinations will not result in an incident by incident review of how a given bank responds to and acts on incident notices?

**Response**: The OCC uses a risk-based supervision process focused on evaluating banks' risk management, identifying material and emerging concerns, and requiring banks to take corrective action when warranted. The OCC's supervision process is outlined in the Comptroller's Handbook.[10] Comments were submitted in response to the proposed rule regarding post-incident supervisory activities, and the agencies are considering that feedback to determine whether changes or clarifications would be needed in any final rule.

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[10] See, e.g., "Bank Supervision Process" booklet of the Comptroller's Handbook.

**Rep. Rose**

Acting Comptroller Hsu:

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

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

It is impossible for ATM operators to do business without having a bank account, but even with the end of the Operation Choke Point, independent ATM providers were increasingly being notified that their deposits accounts where being closed. In December, the OCC announced the Fair Access Rule that was at least a step in the right direction towards combatting future "Chokepoint-type" behavior – unfortunately due to the Administration's regulatory freeze, that rule has been put on hold.

**Question**: Now that the Fair Access Rule has been put on hold, could you describe what the OCC will be doing to address the fallout from Operation Chokepoint and its effect on ATM owners and operators who are still having their accounts closed?

**Response**: The agency's long-standing supervisory guidance, that banks should not terminate categories of accounts without evaluating customers individually, remains in place. The OCC does not direct banks to open, maintain, or close individual accounts or categories of accounts without regard to the risks presented by the individual customers and the bank's ability to manage the relevant risks.

**Rep. Timmons**

Industrial Loan Companies

Late last year, the FDIC finalized regulations that would allow commercial entities to own ILCs. The most recent rule went a step further than the FDIC's abandoned 2007 proposal, which would have restricted ILC ownership by commercial entities.

(To Hsu)
**Question**: As a member of the FDIC Board, is it concerning to you that the FDIC could, potentially, permit a large commercial enterprise to own an ILC?

**Response**:

Given the rapid pace of change, especially in online commerce and payments, I believe ILC applications today warrant heightened scrutiny and coordination with other financial regulators. There should be a coordinated and holistic approach to what entities, activities, services, and structures need to reside inside the bank regulatory perimeter and for which bank holding company supervision is appropriate. The FDIC Board should take this into consideration when evaluating ILC applications.

Lessons from China/Alipay/Wirecard (To Hsu and Quarles)

There are a number of recent developments involving entities outside of the United States, namely Wirecard and Ant Group Co., that highlight some of the systemic risks presented when commercial entities gain significant influence in a nation's financial system. China, realizing that Ant Group Co. presented significant risks to the stability of its financial system, forced the conglomerate into a supervisory framework modeled after the U.S. bank holding company framework and, ultimately, to restructure its business units. The Wirecard scandal left behind billions of dollars in losses for financial markets, notwithstanding Wirecard Card Solutions being an e-money licensed company that was not a deposit-taking bank. The scandal occurred, in part, because of a lack of consolidated supervision by Germany's financial regulator.

**Question**: Have these examples caused U.S. regulators to carefully evaluate the risks posed by commercial entrants to the banking system through novel bank charters and Federal Reserve payment system access?

**Response**: Yes. The OCC is taking a holistic approach to licensing and granting new charters. Shortly after taking office, I requested a review of key regulatory standards and matters pending before the agency, including the interpretative letters and guidance regarding cryptocurrencies and digital assets and pending charter application decisions. It is important that any steps taken are in full coordination with all stakeholders and part of a broader strategy related to the regulatory perimeter.

For each matter, the review is considering a full range of internal and external views, the impact of changed circumstances, and a range of alternatives.

With respect to charters and licensing decisions, notwithstanding the strong oversight and enhanced provisions the OCC requires,[11] I share the concerns of those who maintain that providing charters to fintechs may convey the benefits of being part of the federal banking system without its responsibilities. I also agree with those who recognize that refusing to charter fintechs may encourage growth of another shadow banking system outside the reach of federal regulators. In other words, denying a charter will not make the problem go away, just as granting a charter will not automatically make a fintech safe, sound, and fair.

Recognizing the OCC's unique authority to grant charters, we must find a way to consider how fintechs and payments platforms fit into the banking system, explore the appropriate use of sandboxes to encourage responsible innovation, and coordinate with the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the states to limit regulatory arbitrage and races to the bottom.

[11] The OCC will expect any fintech that receive a federal charter to address the financial needs of consumers and businesses in a fair and equitable manner and support the important goal of promoting the availability of credit.

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

Office of Legislative Affairs

August 13, 2021

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

Dear Chairwoman Waters:

Enclosed are responses of the Federal Deposit Insurance Corporation to questions submitted for the record following the hearing before the Committee on Financial Services on May 19, 2021, entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions."

If you or Committee staff have further questions or comments, please do not hesitate to contact me directly (202) 898-6761.

Sincerely,

M. Andy Jiminez

M. Andy Jiminez
Director
Office of Legislative Affairs

Enclosure

**Congresswoman Joyce Beatty**
**Questions for the Record**
**Full Committee Hearing:**
**"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"**
**House Financial Services Committee**
**May 19, 2021**

**Question # 1**

**This question is for the panel.**

**On January 20, 2021, President Joe Biden signed an executive order on Advancing Racial Equity and Support for Underserved Communities Through the Federal Government which directs the heads of federal Agencies, in consultation with the Director of the Office of Management and Budget, to conduct a review of certain programs and services to assess whether underserved communities and their members face systemic barriers in accessing benefits and opportunities available pursuant to those policies and programs.**

**Do you believe your Agency is covered under the ongoing review, and if not, to what extent has your Agency considered conducting a racial equity audit to determine the extent to which the Agency's policies and practices may contribute to systemic barriers that impede women and people of color within your workforce, via procurement opportunities for Minority- and Women-Owned Businesses (MWOBs) and via the elimination of such barriers through the oversight and examination of regulated entities?**

The Executive Order (Order) excludes independent regulatory agencies from its coverage and therefore does not apply to the Federal Deposit Insurance Corporation (FDIC or Agency). Nevertheless, the FDIC's 2021-2023 Diversity, Equity, and Inclusion Strategic Plan (Strategic Plan)[1] shares key aspects of the Order, and even before the Order we had commenced a comprehensive barrier analysis that seeks to assess whether the FDIC's policies and practices may create barriers affecting the employment experience of any groups within the FDIC workforce. The Strategic Plan also includes a number of initiatives that will further integrate DEI into our hiring, training, and career development programs and incorporate Minority- and Women-Owned Businesses (MWOBs), including law firms and investors, in our business activities.

Conducting a Barrier Analysis

Before the Order was issued, the FDIC began a comprehensive barrier analysis to determine the extent to which its policies and practices may create barriers affecting the employment experience of any groups within the workforce, including for women and people of color. In July 2020, the Agency engaged an external consultant to conduct the barrier analysis, with the goal of identifying and eliminating any root causes of disparities in equal employment opportunities for our employees, to the extent they exist.

[1] *See* FDIC, 2021-2023 Diversity, Equity, and Inclusion Strategic Plan, available at https://www.fdic.gov/about/diversity/pdf/dei2021.pdf.

**Congresswoman Joyce Beatty**
**Questions for the Record**
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In order to obtain meaningful results, the Strategic Plan contains a specific action item to conduct analyses to identify root causes of any barriers to equal employment opportunities, establish timelines to regularly review programs for systemic barriers, and take action to remedy the policies, procedures, or practices found to have created the barriers. This is in addition to, and consistent with, the annual self-assessment and review of the employment policies, practices, and procedures that the Agency conducts as a part of the Equal Employment Opportunity Commission's Management Directive 715.

Moreover, as the Strategic Plan indicates, the FDIC is committed to developing and implementing a program to conduct regular internal audits of its regional, field, and headquarters' offices to identify equal employment opportunity program deficiencies and evaluate barrier analysis efforts.

Expanding Opportunities for MWOBs

The FDIC has implemented a number of policies to expand procurement opportunities for MWOBs, Minority- and Women-Owned Investors, and Minority- and Women-Owned Law Firms, with the FDIC's Office of Minority and Women Inclusion (OMWI) playing a pivotal role in these efforts. The FDIC's Acquisition Policy states that OWMI must be given an opportunity to provide MWOBs for solicitation source lists for requirements greater than $100,000. For each contractual action, at least 33% of the firms solicited must be MWOBs. OMWI also participates as a voting member in contract Technical Evaluation Panels (TEPs), which evaluate each offeror's proposal to identify which firms offer the best value to the FDIC. In addition, OMWI participates in debriefings when MWOBs are not selected. The debriefings provide further opportunities for MWOBs to receive technical assistance and guidance in order to become more competitive for future contracting opportunities at the FDIC.

Over the next several years, we will:

- Explore programs used by other agencies to determine if there are any best practices appropriate for implementation at the FDIC;

- Determine whether new policies, regulations, or guidance documents may be necessary to advance equity in the Agency's actions, programs, and procurement opportunities;

- Host a joint ventures' virtual conference to provide technical assistance to Minority- and Women-Owned Investors;

- Implement and enhance our tool for performing Good Faith Effort Reviews of our contractors and their subcontractors' workforce;

- Develop and implement a portal to support OMWI's vendor outreach activities; and

**Congresswoman Joyce Beatty**
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**May 19, 2021**

- Review the selection process for historically marginalized attorneys and Minority- and Women-Owned Law Firms to determine if there are opportunities to enhance the selection process, within existing guidelines, for legal referral services.

These new initiatives, combined with our current practices, will expand the pool of available vendors, thereby increasing competition and competitive pricing, and bring innovative solutions to support the FDIC's mission.

Regulated Entities

To encourage supervised financial institutions to incorporate the principles of diversity, equity, and inclusion in their own workplaces and operations, the FDIC in 2020 developed a Strategic Roadmap for the Financial Institution Diversity Program to identify a number of programmatic goals:

- To develop and strengthen partnerships with financial institutions, trade organizations, and key stakeholders;

- To maximize the use of technology to make submissions easier for financial institutions while improving our ability to analyze the data submitted;

- To emphasize the benefits of conducting voluntary self-assessments; and

- To make diversity information available to the public.

Most recently, the FDIC co-hosted a Perspective Diversity Director's Symposium with the Ohio Bankers League. The Symposium is aimed at providing diverse individuals with opportunities to become members of bank boards.

While we recognize that more remains to be done, we have seen positive results from our efforts. They are detailed in the FDIC's 2020 Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress.[2]

[2] *See* FDIC, 2020 Section 342 Dodd-Frank Wall Street Reform and Consumer Protection Act Report to Congress, available at https://www.fdic.gov/about/diversity/pdf/rtc-3-31-21.pdf.

**Congresswoman Joyce Beatty**
**Questions for the Record**
**Full Committee Hearing:**
**"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"**
**House Financial Services Committee**
**May 19, 2021**

**Question # 2**

**This question is for the panel.**

**On April 20, 2021, the House Financial Services Committee passed HR 2123 the "Diversity and Inclusion, Data Accountability and Transparency Act" which would amend Section 342 of the "Dodd Frank Wall Street Reform and Consumer Protection Act" to make the sharing of diversity performance data of regulated entities with the Offices of Minority and Women Inclusion mandatory.**

**On an annual basis, covering years 2016 to the present, what percentage of covered entities invited to submit a self-assessment of their diversity and inclusion performance data have provided such data?**

The annual percentage of covered entities invited to submit a self-assessment of their diversity and inclusion performance data that have completed a diversity self-assessment has nearly doubled since 2016:

- 2016 (11.81%)
- 2017 (16.71%)
- 2018 (16.96%)
- 2019 (19.31%)
- 2020 (19.53%).

**Congresswoman Joyce Beatty**
**Questions for the Record**
**Full Committee Hearing:**
**"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"**
**House Financial Services Committee**
**May 19, 2021**

**On an annual basis covering years 2016 to the present, what percentage of entities regulated by the industry were invited to provide a self-assessment of their diversity and inclusion performance data?**

FDIC-regulated financial institutions with 100 or more employees are invited to participate in the diversity self-assessment each year.

| Reporting Period | # Financial Institutions (Invited) | Total Supervised FDIC Institutions* | % Invited Institutions of Total Supervised | # Self-Assessments Received | % Self-Assessments Received |
|---|---|---|---|---|---|
| 2016 | 805 | 3,827 | 21% | 95 | 11.81 |
| 2017 | 820 | 3,669 | 22% | 137 | 16.71 |
| 2018 | 784 | 3,495 | 22% | 133 | 16.96 |
| 2019 | 787 | 3,347 | 24% | 152 | 19.31 |
| 2020 | 773 | 3,230 | 24% | 141 | 19.53 |

*Data source: FDIC Annual Report

**How has the response rate of covered entities to the self-assessment requests impacted your Agency's ability to develop comprehensive, aggregated benchmarks of diversity and inclusion performance among entities regulated by the Agency?**

Initially, participation in the Diversity Self-Assessment instrument in 2016 was low. Through outreach to financial institutions, we learned that some institutions were not participating because they found the process to be arduous and did not understand the potential benefits. To help address this, the FDIC launched a Financial Institutions Diversity Self-Assessment (FID-SA) online portal in 2020. The online portal streamlined and improved the assessment process, significantly reducing the time and resource burden on financial institutions. Additionally, we directly engaged with individual banks and offered technical assistance in completing the voluntary self-assessment in an effort to enhance participation. We will continue taking steps to increase participation in the diversity self-assessment, including through direct outreach to increase institutions' awareness of the FDIC's Financial Institution Diversity Program.

**Representative Warren Davidson**
**Questions for the Record**
**Full Committee Hearing:**
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**Chair McWilliams, on Monday the FDIC put out a request for information pertaining to depository institutions that hold digital assets. I applaud your efforts to seek out such input from the public. As the new ranking member of the FinTech Task Force and as a longtime advocate for blockchain and digital assets, I'm certainly interested in seeing how the FDIC proceeds in this area. All agencies represented before us today are, to some degree, in an exploratory phase when it comes to how they will regulate the digital asset space.**

**Ms. McWilliams, as you know the OCC has conditionally approved a few crypto trust banks already. The next logical step would be for these types of institutions to eventually operate as depository institutions. With that in mind, Ms. McWilliams could you speak to how important it is for prudential regulators to be on the same page when it comes to regulating in this space? Is there any interagency coordination?**

I agree it is important for the prudential banking regulators to coordinate regulation and supervision of banks' activities related to digital assets. The staffs of the FDIC, the Board of Governors of the Federal Reserve System (Federal Reserve), and the Office of the Comptroller of the Currency (OCC) are currently engaged in an interagency process to share knowledge about and work through a broad set of issues related to digital assets. The FDIC also collaborates with other federal regulatory agencies through the Financial Stability Oversight Council's digital asset working group and participates at the Basel Committee on Bank Supervision and the Financial Stability Board, both of which have considered issues related to digital assets.

In May, the FDIC issued a Request for Information (RFI) and invited comment to better understand what banks are doing today and what banks are exploring for the future with respect to digital assets. The comment period for the Request for Information closed on July 16, 2021. We are in the process of reviewing the comments which will help inform our interagency work with our fellow regulators.

**Representative Blaine Luetkemeyer**
**Questions for the Record**
**Full Committee Hearing:**
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**Consumer Data (To Hsu, McWilliams, and Quarles)**

**It is becoming more and more clear how significant a role "big tech" plays in every aspect of the U.S. economy and how the data they hold brings unimaginable power. It's not a stretch to say that some of the largest technology companies, like Google, Apple, and Amazon, are "too big to fail." Despite this, recent actions by the FDIC, the OCC, the Federal Reserve, and state banking authorities, have made it easier for companies like Google, Apple, and Amazon to access the banking system and expand their data troves to a previously unreachable dataset: consumer financial data.**

1. **Do you have concerns about big technology firms, and commercial entities more generally, gaining access to consumer financial data without being subject to the same privacy and data security requirements (including examinations) imposed on banks and their parent companies?**

The FDIC issued 12 CFR Part 354 to codify existing practices utilized by the FDIC to supervise industrial banks and their parent companies, to mitigate undue risk to the DIF that may otherwise be presented in the absence of Federal consolidated supervision of an industrial bank and its parent company, and to ensure that the parent company that owns or controls an industrial bank serves as a source of financial strength for the industrial bank.

As noted in the final rule, the FDIC will evaluate consumer privacy and data protection issues presented by a deposit insurance application, a change in control notice, or a merger application involving an industrial bank (industrial bank applications) on a case-by-case basis. The FDIC also included in the final rule a requirement for a parent company of an industrial bank to inform the FDIC about its systems for protecting the security, confidentiality, and integrity of consumer and nonpublic personal information, as part of the parent company's commitment to submit an annual report to the FDIC. This reporting will provide the FDIC with a better understanding across all of a covered company's financial and nonfinancial affiliates and activities and provide the means to monitor for potential consumer protection risks. When appropriate, the FDIC will also consider imposing heightened requirements specific to industrial banks and parent companies regarding the use of consumer financial data for commercial purposes.

More generally, 12 CFR Part 354 requires an industrial bank and its parent, as a condition of the FDIC's approval, to enter into written agreements with the FDIC that contain commitments to be undertaken by the company to ensure the safe and sound operation of the industrial bank. The required commitments include capital and liquidity support from the parent to the industrial bank, and examination and reporting requirements, and contingency planning. The written agreements may include additional commitments on a case-by-case basis when the FDIC determines that additional controls are appropriate or necessary to mitigate risks unique to the proposal, such as consumer privacy and data protection issues. Parent company compliance with commitments and requirements of the written agreements are subject FDIC examination. In

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addition, the written agreements are enforceable in the same manner as an FDIC order through formal enforcement actions under Sections 8 and 50 of the Federal Deposit Insurance Act.

The commitments in written agreements, coupled with the FDIC's order approving an industrial bank application, are intended to provide the safeguards and protections that the FDIC believes are prudent to impose to maintain the safety and soundness of industrial banks and require a sufficient level of information reporting and parent company obligations.

**Cybersecurity Rulemaking (To Hsu, Quarles, McWilliams)**

**Earlier this year, the Federal Reserve, the OCC, and the FDIC issued proposed rulemaking relating to increased notification standards around what the rule defined as "computer security incidents." With the increased cyber attacks we've seen in the past year, coupled with the dramatic, and necessary, shift to digital and e-commerce solutions for financial institutions in the wake of the COVID-19 pandemic, the intent of this rulemaking is both well timed and valuable to the stability of the system. That said, upon review of the NPR and through discussions with bank service providers and financial institutions alike, it seems that this rulemaking needs further review and amendment before a potential final review.**

**1. Would you be able to provide an update of where this joint rule currently stands? Is it your intent to continue down the rulemaking process and issue a final rule based on the comments received during the NPR?**

On January 12, 2021, the FDIC, Federal Reserve and OCC (the "agencies") issued a notice of proposed rulemaking (NPR) that would require supervised banking organizations to promptly notify their primary federal regulator in the event of a computer security incident.[3] The comment period closed on April 12, 2021. The agencies received 35 comment letters in response to the proposed rulemaking, including approximately 200 specific recommendations from financial services trade associations, individual banks, technology companies, law firms, and others. These comments are available for public review on the regulatory information sections of the agencies' public websites.[4] FDIC staff are in the process of reviewing the comment letters received and are collaborating with peers at the other agencies to consider responsive changes in any final rule.

[3] *See* Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers, 86 Fed. Reg. 2299 (proposed January 12, 2021) (to be codified at 12 CFR Part 304) available at: https://www.fdic.gov/news/board/2020/2020-12-15-notice-sum-c-fr.pdf.
[4] Each of the agencies provides the comments submitted on its website: Federal Reserve, https://www.federalreserve.gov/apps/foia/ViewComments.aspx?doc_id=R%2D1736&doc_ver=1; FDIC: https://www.fdic.gov/resources/regulations/federal-register-publications/2021/2021-computer-security-incident-notification-3064-af59.html; OCC: www.regulations.gov/document/OCC-2020-0038-0001/comment.

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**2. The NPR currently requires any service provider who falls under the BSCA with a requirement to provide immediate notification of a computer security incident that is "believed in good faith could disrupt, degrade, or impair services provided subject to the BSCA for 4 or more hours."**

**a. The NPR does not define "disrupt, degrade, or impair" and my office has heard concerns that the ambiguity within this term could lead to both the over notification to financial institutions and from financial institutions to you, the regulators. Simple question – how do each of you define this phrase? Is there a common definition you're using and planning on providing guidance on?**

In the preamble to the proposed rulemaking, the agencies sought to provide clarity on the meaning of "disrupt, degrade, or impair" by offering several examples of incidents that involved the disruption, degradation, or impairment of services that the agencies intended to be within the scope of the rulemaking.[5]

The FDIC will carefully consider any comments received on this topic and consider responsive changes in any final rule.

**b. Additionally, as written, this rule does not exempt or exclude scheduled maintenance or other planned outages that will inevitably "disrupt, degrade, or impair" as a requirement of updating, servicing, or improving services. Is it your intent to have service providers notify banks of these scheduled maintenance periods?**

The agencies have received comments on the proposed rulemaking that raised the issue of the reporting of scheduled maintenance or other planned outages. The FDIC is reviewing those comments and is considering responsive changes in any final rule.

**3. Most community financial institutions partner with multiple service providers who fall under the BSCA. And most service providers support multiple financial institutions who will have reporting requirements under this NPR. How do you anticipate preventing notification fatigue – the over notification of non-material issues by service providers – and over reporting to the regulator?**

In the NPR, the agencies sought to appropriately balance the risks of over and under reporting. The FDIC appreciates that service providers reporting a significant amount of notifications of non-material issues to multiple financial institutions would not be beneficial, and the NPR was

[5] *See* Computer-Security Incident Notification Requirements for Banking Organizations and Their Bank Service Providers, 86 Fed. Reg. 2299 (proposed January 12, 2021) (to be codified at 12 C.F.R. at Part 304) available at: https://www.fdic.gov/news/board/2020/2020-12-15-notice-sum-c-fr.pdf.

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not intended to result in such over-notification. The agencies received comments regarding this topic and, in compliance with the Administrative Procedure Act, will consider whether changes to the proposed rule are needed to achieve an appropriate balance in any final rule.

> **a. What assurances can you provide to community banks that annual examinations will not result in an incident by incident review of how a given bank responds to and acts on incident notices?**

As part of the information technology risk examination program, FDIC examiners review and evaluate a bank’s incident response policy and procedure implementation.[6] Examiners may sample incident responses to draw conclusions regarding implementation effectiveness; however, in the ordinary case, examiners would not conduct an incident-by-incident review (of incidents at a service provider or at the bank directly).

The agencies received comments recommending that post-incident supervisory activities minimize the burden on banks, and staff are considering those comments to determine whether changes to the proposed rule are needed in any final rule.

[6] *See* Information Technology Risk Examination (InTREx) Program, FIL-43-2016 (June 30, 2016) available at: https://www.fdic.gov/news/financial-institution-letters/2016/fil16043.html

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**Banking Access**

**Chair McWilliams, your testimony detailed how FDIC is focusing on financial inclusion, including efforts to help more folks get access to banking services. Better serving the unbanked and underbanked is an equity issue. According to the 2019 FDIC Survey you cited in your testimony, 13.8% of Black individuals were unbanked while only 2.5% of white individuals were. Too many of my constituents are unbanked or underbanked. And as a Member of Congress who was once unbanked myself, I know how important it is to tackle this issue here in Congress. According to the 2019 FDIC Survey, a couple of the top reasons that unbanked individuals cited for not having a bank account were financial in nature – not having enough money to start a bank account or finding bank fees too high or unpredictable.**

**1. What are some best practices that financial institutions can take to break down barriers like these and make responsible financial services accessible to anyone who's working hard to get ahead?**

Financial inclusion is integral to the FDIC's mission of maintaining stability and public confidence in the nation's financial system and has been a top organizational priority and the focus of a specific corporate performance goal. The FDIC promotes affordable insured transaction and savings accounts with the aim of ensuring that all Americans have access to secure and affordable insured banking services and every bank offers affordable transaction and savings accounts.

The FDIC is taking a multi-pronged approach to tackle the issue of financial inclusion, including:

- an effort to better understand technological advancements occurring in the market place, many of which have the potential to expand access to financial services while ensuring compliance with applicable consumer protection and privacy laws;
- taking steps at the FDIC, including hosting tech sprints with external participants through the Agency's Office of Innovation (FDITECH), to identify additional solutions;
- collaborating with Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs) to better allow them to compete in the modern era, including through the creation of the Mission-Driven Bank Fund; and

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- conducting targeted public awareness campaigns regarding the importance of a banking relationship.[7]

Further, the list below describes actions that the FDIC encourages financial institutions to consider to promote financial inclusion.

- Consider offering affordable and sustainable bank accounts.
    - Consider the benefits of working with a local network that promotes economic inclusion, such as the FDIC's Alliances for Economic Inclusion or Bank On Coalitions. The Bank On program led by the Cities of Financial Empowerment Fund encourages banks to offer accounts that have no overdraft fees; have an opening balance requirement of $25 or less; have low or no maintenance fees; and offer debit cards, bill pay, direct deposit, and accessible customer service.
    - Consider how offering an affordable and sustainable account might allow cultivating and growing successful customer relationships with populations that have higher percentages of unbanked households, such as low- and moderate-income individuals, minorities, and younger consumers.
- Promote the importance of having a banking relationship.
    - Consider providing a link to the FDIC's #GetBanked webpage[8] on the financial institution's website. The FDIC created this dedicated webpage for consumers interested in opening a bank account. The webpage is available in English and Spanish and has dedicated resources that address some of the questions that consumers may have about the importance of having a bank account.
    - Help promote the benefits of having a banking relationship by following FDIC on social media (#FDIC.gov) and using FDIC hashtags (#GetBanked; #FDIC).
    - Conducting financial education, for example by using the FDIC's Money Smart curriculum, to help consumers more effectively use bank accounts to improve their financial well-being.
- Increase the visibility of a financial institution in its communities.
    - Consider reaching unbanked populations with financial education events, using

[7] For more detail regarding these efforts, see Remarks by Jelena McWilliams at "Fintech: A Bridge to Economic Inclusion" (June 29, 2021), available at https://www.fdic.gov/news/speeches/2021/spjun2921.html.

[8] *See* FDIC, #GetBanked (April 5, 2021), available at https://www.fdic.gov/GetBanked.

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each institution's understanding of where the unbanked population is within its footprint.

  - Consider whether the hiring process can assist financial inclusion efforts. For example, consider hiring staff representative of the target community (e.g., bilingual staff).

- Take a focused effort with core service providers.
  - Consider working with core service providers to incorporate an affordable account into the standard account set. If successful, this could make it easier for community banks to offer affordable accounts and to track accounts for positive Community Reinvestment Act consideration.

**Your testimony also referenced that the FDIC is working on a public awareness campaign to help more individuals get banked.**

**2. Can you tell us more about the work that's being done there to break down barriers to banking and connect unbanked individuals to responsible financial services?**

In early April 2021, the FDIC launched a public awareness campaign to inform consumers about the benefits of developing a relationship with a bank in two metropolitan areas, Atlanta-Sandy Springs-Alpharetta, Georgia and Houston-The Woodlands-Sugar Land, Texas, to join the banking system.[9]

As part of a pilot, FDIC ran streaming audio, digital display, mobile video ads, and streaming television ads in these communities between early April and early July. The campaign ads can also be found on the "Get Banked" webpage on FDIC.gov along with other helpful resources, including the top reasons to get banked and a checklist to help consumers choose the best bank account for their individual needs. Consumers are directed to FDIC partners, including the Cities for Financial Empowerment, where they can open an account online or at a branch in their local area.

The campaign is being conducted to help achieve the goal of "promoting the availability, access, and use of affordable, insured transaction and savings accounts," as outlined in the FDIC Economic Inclusion Strategic Plan.[10] This campaign is part of a multi-year initiative, which includes efforts to encourage more banks to offer sustainable accounts, promote stronger local networks that can connect people to the banks, and lead communications initiatives.

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[9] *See* FDIC, #GetBanked (April 5, 2021), available at www.fdic.gov/GetBanked.
[10] *See* FDIC, Economic Inclusion Strategic Plan (June 2019), available at https://www.fdic.gov/consumers/community/documents/eisp.pdf.

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**As we work to help the unbanked, we also need to make sure we help individuals who are not fully unbanked, but may have barriers to using all the responsible financial services that would best suit their needs.**

**3. What is the FDIC doing to help underbanked individuals become better served financially?**

The FDIC is tackling the issue of closing the gap in financial inclusion in several ways. On a biennial basis, the FDIC conducts a survey of households in partnership with the U.S. Census Bureau. The findings from the last survey conducted in June 2019, which collected responses from almost 33,000 households, were published in the FDIC's *How America Banks* report.[11]

We know that community banks, including MDIs and CDFIs, are often the financial lifeblood of many communities and can play an outsized role in closing the gap in financial inclusion. Adopting new technologies that meet the demands of consumers can be especially difficult for these banks, however, which lack the economies of scale of larger institutions. Therefore, the FDIC is pursuing an array of solutions to foster innovation at community banks to increase their ability to serve their communities and to compete effectively in the modern era, some of which are mentioned briefly below.

<u>Mission-Driven Bank Fund</u>

In November 2020, the FDIC announced the establishment of the Mission-Driven Bank Fund that will channel private sector investments to support MDIs and CDFIs, through a variety of asset classes.[12] We have engaged a financial advisor and two law firms to develop the framework, structure, and concept of operations for the fund, but the FDIC will not manage the fund, contribute capital to the fund, or be involved in the fund's investment decisions. Our goal is to be prepared for the fund to accept pitches from MDIs and CDFIs in early 2022.

<u>FDITECH-led Tech Sprints</u>

FDITECH is using "tech sprints" as a novel tool to tackle the gap in financial inclusion. Tech sprints bring together a diverse set of stakeholders (e.g., banks, non-profit organizations, academic institutions, private sector companies, members of the public) in collaborative settings for a short period of time to intensely focus on challenges of importance to the FDIC.

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[11] FDIC, How America Banks (Oct. 2020), available at https://www.fdic.gov/analysis/household-survey/2019report.pdf.

[12] *See* FDIC, 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.

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Last year, the FDIC announced a rapid phased prototyping tech sprint. The Agency's challenge to participants was to promote more regular reporting from community banks, where technology levels vary greatly, without increasing reporting burdens or costs. More than 30 technology firms were invited to participate in this competition,[13] and we recently asked four rapid prototyping participants to propose a proof of concept for their technologies – either independently or jointly.[14] The technologies demonstrated by these vendors show great promise, and the FDIC is reviewing the legal, regulatory, and contractual framework needed to successfully encourage the market to adopt technologies like this. Tools like those developed in this competition will help pave the way for more seamless and timely reporting of more granular data in the future for banks that voluntarily choose to adopt them.

FDITECH's latest tech sprint, announced this past June, explores new technologies and techniques that would help expand the capabilities of community banks to meet the needs of unbanked households.[15] This tech sprint is a public challenge to banks, non-profits, private companies, and others to help us reach that "last mile" of unbanked Americans. Specifically, the FDIC has asked participants to answer the following question: "Which data, tools, and other resources could help community banks meet the needs of the unbanked in a cost-effective manner, and how might the impact of this work be measured?" We accepted registrations in July and recently announced the selection of eight teams to come together for a demonstration day in September.[16]

Community Affairs Program

The FDIC also maintains a Community Affairs Program to promote economic inclusion and community development initiatives that broaden access to safe and affordable credit and deposit services from insured depository institutions.

The Community Affairs Program supports the Agency's effort to bridge the gap in financial inclusion in the following ways:

[13] *See* FDIC, FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html.

[14] *See* FDIC, FDIC Requests Four Companies to Submit Pilot Proposals in Next Phase of Rapid Phased Prototyping Competition (Aug. 9, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21070.html.

[15] *See* FDIC, FDITECH Launches Tech Sprint to Reach More Unbanked People, FIL-43-2021 (June 16, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21043.html.

[16] *See* FDIC, FDITECH Selects Eight Teams in Tech Sprint to Reach the Unbanked (Aug. 12, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21071.html,

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- Convenes and facilitates regional and national webinars targeting five economic inclusion opportunity areas (financial education, insured transaction account and savings, consumer credit, affordable mortgage and small business).

  The program also:

  - Provides information and technical assistance to encourage banks to be responsive to the credit and banking needs of the communities they serve, including low- and moderate-income consumers;
  - Convenes banks, local and state governments, and community-based organizations to explore resources and promising practices;
  - Develops and disseminates financial education tools for children and adults to banks, teachers, parents, emerging small businesses, and non-profit training organizations;
  - Supports pilot programs and alliances to expand financial capability and inclusion; and
  - Helps financial institutions develop credit-building programs and provide access to credit pathways. The Agency helps promote these efforts at a regional and national capacity.

- Develops relationships with community based organizations to strengthen connections between financial institutions and local resources.

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**Industrial Loan Companies**

**Late last year, the FDIC finalized regulations that would allow commercial entities to own ILCs. The most recent rule went a step further than the FDIC's abandoned 2007 proposal, which would have restricted ILC ownership by commercial entities.**

**Acting Comptroller Hsu has testified about a fragmented agency-by-agency approach to rule writing. What type of coordination with the Federal Reserve did the FDIC engage in before finalizing its rulemaking regarding parent companies of industrial loan companies?**

The FDIC values working together with the other Federal banking agencies on rulemakings to the extent possible, and the agencies regularly issue joint rules in order to ensure coordination and consistency in the regulation of the industry. As deposit insurer and the primary Federal prudential regulator for industrial banks, the FDIC has the sole authority to issue rules to ensure the safe and sound operation of industrial banks and for the protection of the Deposit Insurance Fund. The FDIC's rulemaking authority includes carrying out the provisions of the Federal Deposit Insurance Act related to the grant of deposit insurance, mergers, and change-in-control transactions involving industrial banks based on safety and soundness considerations and its assessment of the risk to the Deposit Insurance Fund.

The FDIC's 2020 final rule seeks to ensure adequate supervision of industrial banks owned by financial and commercial companies, consistent with the express Congressional exception of industrial banks from the restrictions on commercial affiliations in the Bank Holding Company Act.[17] The exception does not distinguish between commercial and financial parent companies of industrial banks in excluding them from the definition of "bank." Based on prior supervisory experience, by most key measures of performance and condition, industrial banks have had comparable results to other insured depository institutions and have not posed unique safety and soundness concerns based on the activities of the parent organization.

[17] Parent Companies of Industrial Banks and Industrial Loan Companies, 86 Fed. Reg. 10703 (published February 23, 2021) (to be codified at 12 CFR Part 354).

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**I sent a letter back in November requesting revisions to provisions to the Federal Financial Institutions Examination Council's BSA/AML Examination Manual that may be contributing to a misunderstanding of the independent, non-bank ATM industry. In your response, you said you were going to be looking into those revisions. Could you give me an update of where that is in the process?**

The Federal Financial Institutions Examination Council's (FFIEC) BSA/AML Examination Manual (Manual) is currently undergoing a full review and all chapters have been or will be updated. Importantly, the FDIC has drafted an update to the customer-related section associated with independently-owned ATM owner/operators. We have considered feedback from multiple stakeholders in developing revisions to this Manual section. That updated section will be reviewed by other FFIEC member agencies before the final approval. We believe that the process will ultimately produce a section that provides clarification regarding banks' responsibilities, mitigating controls employed by banks regarding customers, and risk-focused examination procedures.

On a parallel track, in April we met with representatives from the National ATM Council and several ATM owner/operators who shared personal challenges they have experienced maintaining banking relationships, which has helped inform our process.

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[2] *See* FDIC, #GetBanked (April 5, 2021), available at https://www.fdic.gov/GetBanked.

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 - Consider reaching unbanked populations with financial education events, using each institution's understanding of where the unbanked population is within its footprint.

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The campaign is being conducted to help achieve the goal of "promoting the availability, access, and use of affordable, insured transaction and savings accounts," as outlined in the FDIC Economic Inclusion Strategic Plan.[4] This campaign is part of a multi-year initiative, which

[3] *See* FDIC, #GetBanked (April 5, 2021), available at www.fdic.gov/GetBanked.
[4] *See* FDIC, Economic Inclusion Strategic Plan (June 2019), available at https://www.fdic.gov/consumers/community/documents/eisp.pdf.

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**Questions for the Record**
**Full Committee Hearing:**
**"Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions"**
**House Financial Services Committee**
**May 19, 2021**

includes efforts to encourage more banks to offer sustainable accounts, promote stronger local networks that can connect people to the banks, and lead communications initiatives.

**As we work to help the unbanked, we also need to make sure we help individuals who are not fully unbanked, but may have barriers to using all the responsible financial services that would best suit their needs.**

**3. What is the FDIC doing to help underbanked individuals become better served financially?**

The FDIC is tackling the issue of closing the gap in financial inclusion in several ways. On a biennial basis, the FDIC conducts a survey of households in partnership with the U.S. Census Bureau. The findings from the last survey conducted in June 2019, which collected responses from almost 33,000 households, were published in the FDIC's *How America Banks* report.[5]

We know that community banks, including MDIs and CDFIs, are often the financial lifeblood of many communities and can play an outsized role in closing the gap in financial inclusion. Adopting new technologies that meet the demands of consumers can be especially difficult for these banks, however, which lack the economies of scale of larger institutions. Therefore, the FDIC is pursuing an array of solutions to foster innovation at community banks to increase their ability to serve their communities and to compete effectively in the modern era, some of which are mentioned briefly below.

Mission-Driven Bank Fund

In November 2020, the FDIC announced the establishment of the Mission-Driven Bank Fund that will channel private sector investments to support MDIs and CDFIs, through a variety of asset classes.[6] We have engaged a financial advisor and two law firms to develop the framework, structure, and concept of operations for the fund, but the FDIC will not manage the fund, contribute capital to the fund, or be involved in the fund's investment decisions. Our goal is to be prepared for the fund to accept pitches from MDIs and CDFIs in early 2022.

[5] FDIC, How America Banks (Oct. 2020), available at https://www.fdic.gov/analysis/household-survey/2019report.pdf.

[6] *See* FDIC, 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.

**Representative Nikema Williams**
**Questions for the Record**
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FDITECH-led Tech Sprints

FDITECH is using "tech sprints" as a novel tool to tackle the gap in financial inclusion. Tech sprints bring together a diverse set of stakeholders (e.g., banks, non-profit organizations, academic institutions, private sector companies, members of the public) in collaborative settings for a short period of time to intensely focus on challenges of importance to the FDIC.

Last year, the FDIC announced a rapid phased prototyping tech sprint. The Agency's challenge to participants was to promote more regular reporting from community banks, where technology levels vary greatly, without increasing reporting burdens or costs. More than 30 technology firms were invited to participate in this competition,[7] and we recently asked four rapid prototyping participants to propose a proof of concept for their technologies – either independently or jointly.[8] The technologies demonstrated by these vendors show great promise, and the FDIC is reviewing the legal, regulatory, and contractual framework needed to successfully encourage the market to adopt technologies like this. Tools like those developed in this competition will help pave the way for more seamless and timely reporting of more granular data in the future for banks that voluntarily choose to adopt them.

FDITECH's latest tech sprint, announced this past June, explores new technologies and techniques that would help expand the capabilities of community banks to meet the needs of unbanked households.[9] This tech sprint is a public challenge to banks, non-profits, private companies, and others to help us reach that "last mile" of unbanked Americans. Specifically, the FDIC has asked participants to answer the following question: "Which data, tools, and other resources could help community banks meet the needs of the unbanked in a cost-effective manner, and how might the impact of this work be measured?" We accepted registrations in July and recently announced the selection of eight teams to come together for a demonstration day in September.[10]

Community Affairs Program

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[7] *See* FDIC, FDIC Launches Competition to Modernize Bank Financial Reporting (June 30, 2020), available at https://www.fdic.gov/news/press-releases/2020/pr20079.html.

[8] *See* FDIC, FDIC Requests Four Companies to Submit Pilot Proposals in Next Phase of Rapid Phased Prototyping Competition (Aug. 9, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21070.html.

[9] *See* FDIC, FDITECH Launches Tech Sprint to Reach More Unbanked People, FIL-43-2021 (June 16, 2021), available at https://www.fdic.gov/news/financial-institution-letters/2021/fil21043.html.

[10] *See* FDIC, FDITECH Selects Eight Teams in Tech Sprint to Reach the Unbanked (Aug. 12, 2021), available at https://www.fdic.gov/news/press-releases/2021/pr21071.html.

**Representative Nikema Williams**
**Questions for the Record**
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The FDIC also maintains a Community Affairs Program to promote economic inclusion and community development initiatives that broaden access to safe and affordable credit and deposit services from insured depository institutions.

The Community Affairs Program supports the Agency's effort to bridge the gap in financial inclusion in the following ways:

- Convenes and facilitates regional and national webinars targeting five economic inclusion opportunity areas (financial education, insured transaction account and savings, consumer credit, affordable mortgage and small business).

  The program also:

  - Provides information and technical assistance to encourage banks to be responsive to the credit and banking needs of the communities they serve, including low- and moderate-income consumers;
  - Convenes banks, local and state governments, and community-based organizations to explore resources and promising practices;
  - Develops and disseminates financial education tools for children and adults to banks, teachers, parents, emerging small businesses, and non-profit training organizations;
  - Supports pilot programs and alliances to expand financial capability and inclusion; and
  - Helps financial institutions develop credit-building programs and provide access to credit pathways. The Agency helps promote these efforts at a regional and national capacity.

Develops relationships with community based organizations to strengthen connections between financial institutions and local resources.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

December 24, 2021

The Honorable French Hill
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 19, 2021,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 23, 2021.

**<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Hill:</u>**

1) **Vice Chairman Quarles, in numerous forums including previous Congressional testimony, you have suggested that you and Chairman Powell support "maintaining" the total level of loss absorbing capacity in the system and that capital is not likely to increase in the aggregate with further Basel III implementation. I am supportive of your goal of harmonizing and simplifying the various capital regimes the Federal Reserve has stood up post-crisis.**

    a. **Before we get into details, I just want to confirm your continued commitment to capital neutrality in the aggregate?**

The regulatory capital framework introduced since the financial crisis has required banks to significantly strengthen their capital levels over the last decade. As a result, the banking system was well capitalized at the onset of the COVID event and banks were in a strong position to deal with the challenges posed by the COVID event. I consider the current capital level of banks to be generally appropriate in the aggregate and the Federal Reserve Board (Board) will continue to maintain the overall strength of bank capital requirements.

   b. **As the Fed works to complete its economic analysis to support further Basel III implementation, will the Fed commit to completing an analysis of the proposed revisions on all categories of subject banking organizations, including, for example, IHCs, which have been left out of some prior quantitative impact studies that focused only on domestic bank holding companies?**

As a general matter, economic impact analyses associated with proposed rulemakings focus on the banking organizations to which a given proposal would apply. Under the current capital framework, the Basel-based advanced approaches apply to Category I organizations (U.S. global systemically important firms) and Category II organizations (firms of global scale with more than $700 billion in assets or more than $75 billion in cross-jurisdictional activity). This is consistent with the approach the federal banking agencies described in the 2019 tailoring rule—that is, applying requirements that reflect agreements reached by the Basel Committee is appropriate for the risk profiles of banking organizations in these two categories. As of 2021, no intermediate holding company (IHC) exceeds the relevant thresholds to qualify as a Category I or II organization and therefore no IHC is currently subject to the advanced approaches framework. While all IHCs are currently classified as Category III or below, some IHCs could rise to Category II status in the future depending on their activities in the United States. As we develop the proposal to implement the outstanding Basel III capital reforms in the United States, including determining the proposed scope of application, our related analysis would incorporate any firms that would be in scope.

   c. **And finally, how does the Fed intend to release the economic impact analysis to ensure transparency of impact across all categories of institutions?**

Consistent with our general practice, we would include a discussion of economic impact of the proposed rule to implement the outstanding Basel III reforms in the United States in the Federal Register.

**2) In the tailoring framework finalized in 2019, the Federal Reserve took a major step to align regulatory expectations and guidance with the size and risk of institutions. However, there is more work to done. For example, the scope of application of the Global Market Shock ("GMS") and Counterparty Default Scenario ("CDS") is overbroad and should be revised to apply only to the largest and most complex firms. As the Federal Reserve implements its capital and liquidity regulations known as the "Basel III end-game", does the Federal Reserve plan to apply the same tailoring principle and apply the most stringent requirements, such as GMS and CDS, to the largest and most complex institutions (i.e., Category I and/or II) only?**

The Board has taken multiple steps to improve the regulatory framework by tailoring financial regulation to risk. This principle is already embedded in several aspects of our supervisory framework. For example, while banking organizations with $100 billion or more in total assets are subject to the supervisory stress test, only Category I-III banking organizations with significant trading activity are also subject to the Global Market Shock component of the supervisory stress test. Furthermore, only banking organizations with substantial trading or custodial operations are subject to the Counterparty Default Scenario component (i.e., the unexpected default of the firm's largest counterparty) of the supervisory stress test.

The U.S. federal banking agencies are currently developing a proposed rule that would implement the Basel III reforms. In developing the proposal, the interagency staff team is balancing various objectives, including capital comparability, capital adequacy, risk sensitivity and tailoring, and competitive equity. Any changes to the Board's capital rule would be done in accordance with applicable law.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

December 24, 2021

The Honorable Trey Hollingsworth
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the May 19, 2021,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 23, 2021.

**Question for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Hollingsworth:**

1) **As we heard some of my colleagues bring up during the hearing on May 19th, the Federal Reserve continues to become more active in the space involving climate financial risk. This includes recently creating the Financial Stability Climate Committee to identify, assess, and address climate-related risks to financial stability – and this is on top of the creation of the Fed's new Supervision Climate Committee. What I would like to know is how the Fed plans to regulate climate financial risk, specifically in the context of stress testing. There certainly seems to be a lot of uncertainties around the concept. In "The Green Swan - Central Banking and Financial Stability in the Age of Climate Change," the authors themselves point out that the effects of climate change on the planet are 'highly nonlinear, meaning that small changes in one part can lead to much larger changes elsewhere.' Further, they say that 'highly nonlinear systems can lead to chaotic dynamics, which are extremely difficult to model with any accuracy and confidence.' Vice Chair Quarles, if we are trying to create new financial regulations around something that is extremely difficult to model with any accuracy or confidence, what assumptions would the Fed make in creating stress tests or other climate regulations applicable to financial institutions?**

We have not made any decisions regarding the supervision or regulation of climate-related risks with respect to our supervised firms. We are taking a transparent data-driven approach in assessing the potential for these risks to impact the macroeconomy, financial institutions, and the financial system more broadly, and observing how supervised firms are identifying, assessing, and monitoring these risks.

Climate scenario analysis is one of many tools that banks and international supervisory authorities are developing to better understand the range of potential climate-related risks. It is distinct from existing regulatory stress tests for banks. Regulatory stress tests are used to assess capital adequacy under specific shocks in the short term and have specific consequences for capital and supervisory ratings. By contrast, climate-related scenarios analysis is typically longer-term and exploratory in nature and used to understand and evaluate the potential impact of climate change on a bank's risk profile and strategy across a range of plausible scenarios.

The tool also can build awareness of climate risk across financial institutions and inform our own understanding of the potential economic and financial effects of government policies and technological innovation related to climate change. As you note, however, there are many challenges to this work. For example, the links between emissions, temperature rise, and economic effect are all uncertain and difficult to model, especially over an extended time horizon.

We are building our understanding in this area by engaging with financial institutions, academics, and other central banks and institutions, including through the Financial Stability Board, the Basel Committee on Banking Supervision, and the Network for Greening the Financial System.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

December 24, 2021

The Honorable Blaine Luetkemeyer
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 19, 2021,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 23, 2021.

**<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:</u>**

1) **It is becoming more and more clear how significant a role "big tech" plays in every aspect of the U.S. economy and how the data they hold brings unimaginable power. It's not a stretch to say that some of the largest technology companies, like Google, Apple, and Amazon, are "too big to fail." Despite this, recent actions by the FDIC, the OCC, the Federal Reserve, and state banking authorities, have made it easier for companies like Google, Apple, and Amazon to access the banking system and expand their data troves to a previously unreachable dataset: consumer financial data.**

   **Do you have concerns about big technology firms, and commercial entities more generally, gaining access to consumer financial data without being subject to the same privacy and data security requirements (including examinations) imposed on banks and their parent companies?**

Federal banking law requires banks to keep consumers' data safe and secure, and the Federal Reserve is committed to exercising its supervisory and enforcement authority to ensure that banks comply with those requirements. Accordingly, examiners regularly review the cybersecurity and third-party risk management practices of the banks, considering the security of bank and customer data.

Some consumers choose to make their financial data available to nonbanks, including large technology companies. Section 1033 of the Dodd-Frank Wall Street Reform and Consumer Protection Act authorizes the Consumer Financial Protection Bureau (CFPB) to regulate aspects of consumers' access to their financial data and requires that, subject to rules prescribed by the CFPB, financial institutions generally must make consumer financial data available to consumers or their delegates, such as fintech firms or data aggregators.

To that end, on November 6, 2020, the CFPB published an Advance Notice of Proposed Rulemaking (ANPR) to solicit comments and information to assist in potentially developing regulations to implement section 1033.

2) **Earlier this year, the Federal Reserve, the OCC, and the FDIC issued proposed rulemaking relating to increased notification standards around what the rule defined as "computer security incidents." With the increased cyber attacks we've seen in the past year, coupled with the dramatic, and necessary, shift to digital and e-commerce solutions for financial institutions in the wake of the COVID-19 pandemic, the intent of this rulemaking is both well timed and valuable to the stability of the system. That said, upon review of the NPR and through discussions with bank service providers and financial institutions alike, it seems that this rulemaking needs further review and amendment before a potential final review.**

   **Would you be able to provide an update of where this joint rule currently stands? Is it your intent to continue down the rulemaking process and issue a final rule based on the comments received during the NPR?**

The Federal Reserve Board (Board), Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation (the agencies) issued a final rule on November 23, 2021. The rule will become effective on April 1, 2022, with a compliance date of May 1, 2022.

The final rule reflects a number of changes made in response to comments received, including: (i) modifications to the definition of "computer-security incident" intended to provide further clarity and reduce the potential for over-reporting; (ii) removal of references to "impair," which was redundant with "disrupt or degrade;" (iii) offering a number of examples of computer-security incidents that the agencies consider to be within the scope of the rulemaking; and (iv) not requiring notification from bank service providers of any disruption or degradation to covered services caused by scheduled maintenance, testing, or a software update previously communicated to a banking organization customer. These changes were intended to strike the right balance between the burdens of over-reporting and the risks of under-reporting.

With respect to examinations, the Federal Reserve System's annual examinations are risk-focused, and are not intended to conduct – nor do they lend themselves to conducting – incident by incident reviews of responses to incident notices.

**3) The NPR currently requires any service provider who falls under the BSCA with a requirement to provide immediate notification of a computer security incident that is "believed in good faith could disrupt, degrade, or impair services provided subject to the BSCA for 4 or more hours."**

   **a. The NPR does not define "disrupt, degrade, or impair" and my office has heard concerns that the ambiguity within this term could lead to both the over notification to financial institutions and from financial institutions to you, the regulators. Simple question – how do each of you define this phrase? Is there a common definition you're using and planning on providing guidance on?**

   **b. Additionally, as written, this rule does not exempt or exclude scheduled maintenance or other planned outages that will inevitably "disrupt, degrade, or impair" as a requirement of updating, servicing, or improving services. Is your intent to have service providers notify banks of these scheduled maintenance periods?**

Please see response to Question 2.

**4) Most community financial institutions partner with multiple service providers who fall under the BSCA. And most service providers support multiple financial institutions who will have reporting requirements under this NPR. How do you anticipate preventing notification fatigue - the over notification of non-material issues by service providers -and over reporting to the regulator? What assurances can you provide to community banks that annual examinations will not result in an incident by incident review of how a given bank responds to and acts on incident notices?**

Please see response to Question 2.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

December 24, 2021

The Honorable John Rose
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the May 19, 2021,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 23, 2021.

**Question for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Rose:**

1) **In November, the Fed took important steps to provide temporary relief for certain community banking organizations who experienced an unexpected and sharp increase in assets due to their participation in federal coronavirus response programs-such as the Paycheck Protection Program. That regulatory relief is in effect until December 31, 2021.**

   **With the PPP program just now exhausting funds and the large backlog of forgiveness applications, do you believe that that deadline will be sufficient, and would you be open to extending regulatory flexibility past that date?**

   **And building off of that, I hear constantly from banks back home in Middle Tennessee that regulatory compliance continues to be burdensome. So, I think this brings up the broader question of if we should be looking into permanently raising the threshold for increased regulatory and reporting standards for community banking organizations. What are your thoughts on that, Vice Chair Quarles, and is that something you would support?**

Community banking organizations experienced substantial asset growth at the beginning of the COVID-19 event, in part due to participation in various programs instituted by the federal government. As you note, the federal banking agencies promulgated an interim final rule in December 2020 that provides temporary relief for community banking organizations that crossed certain asset-based regulatory and reporting thresholds of $10 billion or less after December 31, 2019. The interim final rule provided that the relief would last through December 31, 2021, to allow community banking organizations sufficient time to either reduce their balance sheets or prepare for higher regulatory and reporting standards.

The Board is aware of requests made to the Board and the other federal banking agencies to extend the temporary regulatory and reporting threshold relief beyond December 31, 2021. Whether to provide further relief reflects a balance between certain community banking organizations' need for additional time to prepare for higher regulatory and reporting standards and the consequences of the unlevel playing field that further relief would cause for similarly sized banking organizations.

Federal Reserve System supervisory staff have informed Board-supervised community banking organizations that they should prepare for the relief provided by the asset threshold interim final rule to expire as scheduled. Certain regulatory and reporting requirements within the scope of the interim final rule provide a banking organization that becomes newly subject to a requirement a transition period before it must comply with the requirement. Banking organizations that become newly subject to requirements due to the expiration of relief under the interim final rule would qualify for those transition periods.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, DC 20551

December 24, 2021

The Honorable William R. Timmons IV
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 19, 2021,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 23, 2021.

**<u>Questions for The Honorable Randal K. Quarles, Vice Chair for Supervision, Board of Governors of the Federal Reserve System from Representative Timmons:</u>**

1) **There are a number of recent developments involving entities outside of the United States, namely Wirecard and Ant Group Co., that highlight some of the systemic risks presented when commercial entities gain significant influence in a nation's financial system. China, realizing that Ant Group Co. presented significant risks to the stability of its financial system, forced the conglomerate into a supervisory framework modeled after the U.S. bank holding company framework and, ultimately, to restructure its business units. The Wirecard scandal left behind billions of dollars in losses for financial markets, notwithstanding Wirecard Card Solutions being an e-money licensed company that was not a deposit-taking bank. The scandal occurred, in part, because of a lack of consolidated supervision by Germany's financial regulator.**

   **Have these examples caused U.S. regulators to carefully evaluate the risks posed by commercial entrants to the banking system through novel bank charters and Federal Reserve payment system access?**

The Federal Reserve is actively following developments in the consideration and issuance of new or proposed types of novel banking charters at the state level and by the Office of the Comptroller of the Currency (OCC). These novel bank charters raise a host of legal and policy questions under the Federal Reserve Act, including whether charter recipients would become Federal Reserve members or have access to Federal Reserve accounts and payment services. In addition, depending on the business model and charter at issue, the parent company and other affiliates of an institution may come under consolidated supervision by the Federal Reserve under the Bank Holding Company Act (BHC Act). When institutions' particular charters and activities are subject to different regulatory and supervisory regimes, regulatory arbitrage opportunities may arise, which could allow for the mixing of banking and commerce, cause competitive distortions, and increase risks to safety and soundness and financial stability.

Recent years have seen the introduction of new financial products and delivery mechanisms for traditional banking services, notably leveraging emerging technologies, including from institutions with, as you note, novel types of banking charters designed to support such innovation. To facilitate these activities, some such institutions have requested access to the payment services offered by Federal Reserve Banks. To help achieve the goal of applying a transparent and consistent process for all access requests, as well as to enable appropriate consideration of the ramifications for the broader financial system, the Federal Reserve Board proposed for public comment last summer Account Access Guidelines for the Reserve Banks to evaluate such requests.[1]

These proposed guidelines take into account the Federal Reserve's legal authority and reflect an analysis of its policy goals. With technology driving rapid change in the payments landscape, the proposed Account Access Guidelines would ensure requests for access to Federal Reserve payment services from novel institutions are evaluated in a consistent and transparent manner that promotes a safe, efficient, inclusive, and innovative payment system, consumer protection,

[1] See Proposed Guidelines for Evaluating Account and Services Requests

and the safety and soundness of the banking system. Specifically, the proposed approach is based on a foundation of risk management and mitigation and recognizes that risks to the Reserve Banks, to the payment system, to financial stability, and to the effective implementation of monetary policy, among others, may arise when an institution gains access to a Federal Reserve account and services. The Board has received comments from a broad set of stakeholders, including institutions and trade associations representing both traditional and nontraditional charters, as well as chartering authorities, academics, think tanks, and members of Congress. The comments received reflect broad support for consistency and transparency in Reserve Bank evaluation of requests for accounts and services but differ in their views about how best to achieve those goals. Staff are analyzing the comments and working to finalize the guidelines.

2) **Following a hearing held in this committee earlier this year, I expressed that there is uncertainty about the posture the new administration will take during negotiations at the International Association of Insurance Supervisors. As such, I asked Chairman Powell if under a new Administration the Fed would commit to fighting to ensure U.S. capital standards are recognized as outcome-comparable to the International Capital Standard (ICS). In his response, which I received last week, Chair Powell told me that the Fed advocates for the U.S. approach to insurance regulation at the IAIS and committed that the Fed would continue to advocate for the Aggregation Method, designed to help regulators assess the adequacy of group capital, to be deemed an outcome-equivalent approach for implementation of the ICS. Vice Chair Quarles, will you make the same commitment to advocating for the Aggregation Method to be outcome-equivalent in defending the strong state-based system of insurance regulation enjoyed by policyholders here in the United States? Will your appearance next week at the NAIC's International Insurance Forum be a chance to make such a public commitment?**

As I stated in my speech at the National Association of Insurance Commissioners' International Forum, the Federal Reserve will continue to advocate for the Aggregation Method (AM) to be deemed an outcome-equivalent approach for implementation of the International Capital Standard (ICS). As currently constructed, the ICS would not be an appropriate capital rule for U.S. internationally active insurance groups. Accordingly, the U.S. and other interested jurisdictions have worked to develop the AM, which could be considered an equivalent implementation of a group capital rule for large, internationally active insurers in the U.S.

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