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THE SEMIANNUAL TESTIMONY ON THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF THE FINANCIAL SYSTEM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING HOW THE FEDERAL RESERVE CAN STAND UP FOR WORKERS AND FAMILIES AND HELP CREATE A BETTER ECONOMY THAT WORKS FOR EVERYONE

MAY 25, 2021

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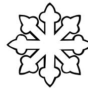

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THE SEMIANNUAL TESTIMONY ON THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF THE FINANCIAL SYSTEM

TUESDAY, MAY 25, 2021

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

The Committee met at 10:01 a.m., via Webex, Hon. Sherrod Brown, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN SHERROD BROWN

Chairman BROWN. The Senate Committee on Banking, Housing, and Urban Affairs will come to order.

This hearing is in the virtual format. For those joining remotely, a few reminders. Once you start speaking, there will be a slight delay before you are displayed on the screen. To minimize background noise, please click the mute button.

You should all have one box on your screens labeled "Clock". For all Senators, the 5-minute clock still applies for your questions. At 30 seconds remaining, you will hear a bell ring to remind you your time has almost expired. It will ring again when it has expired.

If there is a tech issue, we will move to the next Senator until it is resolved. To simplify the speaking order process, Senator Toomey and I have agreed, as at other hearings, to go by seniority.

A year ago today, we watched for 8 minutes and 46 seconds as police murdered George Floyd. Across the country, we saw Americans demand justice for the killings of too many Black and Brown Americans and an end to systemic racism in our country.

Over the past year, the pandemic has taken half-a-million American lives, wreaked havoc on small businesses, pushed families into foreclosure or eviction, and forced millions of workers—many women and workers of color—out of the workforce.

For most Americans, it has been an arduous, long, difficult year, a year that revealed what many of us already knew: that even before the pandemic, our economy was not working for most people.

I have heard some people, including many of my conservative colleagues, say that we had the best economy in our lifetime before the coronavirus hit. Those people need to follow President Lincoln's admonition to go and out and get their public opinion baths.

It certainly was not the greatest economy for most people in Senator Toomey's hometown in Rhode Island or my hometown of Mansfield, Ohio.

Workers' wages have been flat for decades. Jobs continued to move overseas. In my hometown, companies like Westinghouse, Fisher-Body, Tappan Stove, and Mansfield Tire, employing literally tens of thousands of people, companies like that closed down, one after another. Those good union, mostly union jobs disappeared.

They were not replaced by new investment. The "creative DEstruction" the market fundamentalists like to talk about was not followed by any CONstruction, creative or otherwise.

Yet corporate profits continue to climb; CEO pay has soared.

Those outcomes are, of course, connected, as we know.

Corporations lay off workers or cut pay and benefits to juice their stock price. Companies close down factories and move good-paying union jobs abroad to cut costs. Big banks keep getting bigger, fueling the concentration of corporate power in every part of our economy—from agriculture to health care to manufacturing.

The economy of the past few decades may have looked good from the big windows of corporate board rooms figuratively or literally looking down on Wall Street, or from the Dirksen Senate Office Building.

But the economy has not looked great in a long time when looking out from the small towns and rural communities that the big banks have left behind in search of higher profits. And it has never looked all that great for the Black and Brown families who lost their homes and wealth in the wake of the Great Recession, barely getting back on their feet before the next crisis hit.

When I talk to Ohioans, I hear a constant refrain: People do not trust banks, especially the biggest banks. They have been burned by predatory mortgages, high overdraft fees, and expensive second-chance accounts.

They have watched Wall Street reward themselves despite scandal after scandal. They remember how Wall Street bounced back after they wrecked our economy. They know Washington allowed that destruction to happen, and they certainly remember that taxpayers were forced to foot the bill.

Tomorrow, for the first time ever, this Committee will bring the CEOs of the six largest banks in the country to testify in front of us. Our job is to hold accountable the institutions that for far too long have had outsized power in our economy—power that only continues to grow.

Today we will hear testimony from the Federal Reserve's Vice Chair for Supervision, the person responsible for supervising these banks.

Mr. Quarles, checking Wall Street's power is supposed to be your job, too.

It is your responsibility to enforce the law and to hold banks accountable for misdeeds with meaningful punishments—not slaps on the wrist, not paltry fines that do not make a dent. For gargantuan Wall Street firms, a fine is just a minor cost of doing business.

It is your job to stand up for the people who do not have corporate lobbyists, who do not make millions of dollars a year, who do not get bailouts.

But as far as I can tell, you do not view standing up to Wall Street as part of your job. You have rolled back rule after rule—rules that are supposed to be a check on the power of the biggest

banks and supposed to ensure they invest in the real economy, not in themselves.

Instead of investments in job creation and wages and new technology, they continue to pour so much extra cash into riskier and riskier bets and buying back more of their own stock.

Good for them—but not so good for America.

We need, you need, to bring the focus back to the people who make this country work.

We need, you need, to make sure banks are taking into account climate risk. We need, and you need, to make sure that volatile, unregulated cryptocurrencies do not crash the economy and harm consumers.

We need to make sure workers' wages keep up with the cost of living: housing, childcare, prescription drugs, all the expenses that have been rising for decades now.

We need to close the racial wealth gap and income gap that keeps getting wider and wider and wider.

It is our responsibility to work on solving these problems—not for the biggest banks, but for the people whom we serve.

If we want an economy that reflects our values, we cannot let Wall Street write the rules. We cannot tell the regulators how to do their jobs, for that matter. Our financial watchdogs should not be doing favors for the biggest banks.

Vice Chair Quarles, you work for the American people. I want to hear how you are going to stand up for workers and families and help create a better economy that works for everyone.

Senator Toomey.

OPENING STATEMENT OF SENATOR PATRICK J. TOOMEY

Senator TOOMEY. Thank you, Mr. Chairman, and welcome Vice Chairman Quarles.

Congress has provided the Fed with a great deal of independence in order to isolate it from political influence. However, Congress has also given the Fed narrowly defined monetary and regulatory missions.

In the regulatory domain, the Fed has the authority to ensure the safety and soundness of the financial institutions that it regulates. It does not have the authority to seek out and address political or theoretical risks in the distant future.

The Fed's recent actions raise concerns that it is losing sight of this constraint. Consider its increasing focus on the supposed risks of global warming to the financial system. In March, John Cochrane, a distinguished economist at Stanford University, powerfully argued before this Committee that, and I quote, "climate change poses no measurable risk to the financial system."

Put simply, neither the warming of the Earth's temperature nor severe weather events are a threat to the stability of the financial system. Experience bears this out. In the last 11 years—a time period that included four of the five costliest hurricanes in U.S. history—we have not found one bank failure caused by any weather event. In fact, we are not aware of any bank failure in the modern era due to weather.

Nevertheless, the Fed recently joined the Network of Central Banks and Supervisors for Greening the Financial System. The

network's stated aim is to use financial regulation to "mobilize mainstream finance to support the transition toward a sustainable economy." In other words, to direct credit away from fossil fuels.

Such actions are not consistent with the Fed's mandate and authorities. As Chair Powell himself has said, and this is a quote, "society's broad response to climate change is for others to decide—in particular, elected leaders."

It is my view that if Congress believes current environmental laws do not adequately address global warming risks, then changes should be enacted through the legislative process by those who are accountable to voters—not by financial regulators who have neither expertise nor accountability.

This principle extends to other issues as well. I am troubled that regional Fed banks are focusing on politically charged issues, like racial justice activism, that are also outside the Fed's mission and expertise. This week I sent letters to three regional Federal Reserve Banks about this behavior and requested information from them.

Instead of seeking to tackle issues that are outside the Fed's mandate and authorities, the Fed should focus on supervising the risks within its domain. For example, the Fed's recent Financial Stability Report highlights several risks that should be monitored, including high asset prices. However, the report fails to consider a primary cause of these risks—that is, the Fed's own excessively accommodative monetary policy.

Our economy experienced a tremendous shock last year, but it was met with unprecedented monetary and fiscal support. And the economy is now in full recovery mode. As a result, I do not understand the justification for the Fed maintaining its policy of near-zero interest rates and $1.4 trillion in bond purchases per year, amounting to roughly half of all new Treasury debt issuance since the beginning of the pandemic. Let us not kid ourselves: We are effectively monetizing about $1 trillion of Federal debt per year.

And this is especially troubling because the warning signs of inflation have been getting louder. We may be seeing asset bubbles forming already, and history is replete with examples where the bursting of bubbles led to financial instability. As President Clinton's Treasury Secretary Larry Summers noted yesterday, the Fed needs to start, and I quote, "explicitly recognizing that overheating, and not excessive slack, is the predominant near-term risk for the economy."

I am concerned that the Fed's current approach almost guarantees that it will be behind the curve if inflation does become problematic and persistent—for two reasons. First, the Fed has announced it will allow inflation to run above its 2-percent target level for some indefinite period. And, second, the Fed insists that the inflation we are experiencing now is just transitory. But you can only know something is transitory when it has come to an end. What if it does not come to an end?

Another side effect of the Fed's asset purchases is the regulatory implications of such an abundance of reserves in the banking system. When the Fed purchases Treasurys or agency securities, the aggregate level of reserves rises correspondingly. As a result, reserves in the banking system have risen by over $2 trillion, and

bank leverage ratios have experienced pressure from absorbing these riskless reserves that the Fed is creating.

Last year, the Fed recognized this problem and issued temporary relief that allowed banks to accommodate a surge of reserves. That relief has expired, and there are signs that it was needed. The Fed recently stated that it will address this problem on a permanent basis. Mr. Vice Chairman, I hope you will do so swiftly.

Let me conclude with this: The Fed does not need to exceed its mandate and authorities to find risks to address. The siren calls of politically charged endeavors should be ignored, in order to preserve the credibility and independence of the Fed. There are plenty of risks within its reach, including those to which it may be contributing.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Toomey.

I will now introduce today's witness. We will hear from Federal Reserve Vice Chair for Supervision Randal Quarles on the Fed's supervision and regulation of banks and financial firms. The Federal Reserve, as we know, plays a key role in making sure we have a strong financial system that works for all Americans.

Vice Chair Quarles, thank you for your service, thank you for testifying today. You are recognized. Thank you.

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

Mr. QUARLES. Thank you. Thank you, Chairman Brown, Ranking Member Toomey, Members of the Committee. Thank you for the invitation to testify today.

Last May, 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. And a year ago, the full implications of the COVID event 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.

As the Federal Reserve's recent reports detail, banking organizations have remained an important source of strength in this recovery. Higher levels of capital and liquidity, better risk management, and more robust systems let banking organizations absorb 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 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, but 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 the 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.

Most immediately, we have worked to align our emergency actions with other relief efforts, as the economic situation improves, maintaining or extending some of measures, where appropriate, to preserve household assistance and promote continued access to credit, and starting the transition back to our normal activities, our normal supervisory posture, and our normal rule book.

However, our role and 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.

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 the system, we now know that the system works, especially when supplemented and informed by a real-time stress-testing regime. 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' ability or willingness to intermediate, and changing patterns in the use of financial services by consumers and businesses. 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.

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 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 postcrisis Basel III reforms and completing the long-overdue transition away from 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 the financial system is resilient enough to support consumers, households, and businesses, and recommit ourselves to supporting the economy through the completion of the recovery.

Thank you, and I look forward to your questions.

Chairman BROWN. Thank you very much, Mr. Vice Chair. I appreciate your comments.

After George Floyd's funeral, Chair Powell acknowledged, "This tragic event put a spotlight on the pain of racial injustice in this country." He went on to say, "There is no place in the Federal Reserve for racism, and there should be no place for it in our society."

Do you agree with that statement, Vice Chair Quarles?

Mr. QUARLES. Wholeheartedly.

Chairman BROWN. Thank you.

When we say "systemic racism," we mean all the decisions people and institutions make that hold people in communities of color back. You have issued rules that make it easier for the biggest banks to make risky bets instead of investing in the real economy. You failed to take action against banks for lending discrimination. Don't these decisions contribute to systemic racism?

Mr. QUARLES. Well, I am not sure what instances you are referring to that we failed to take action on lending violations. We are quite aggressive in pursuing fair lending violations and other sorts of discriminatory behavior in the banking industry.

Chairman BROWN. Well, read the history of the Fed, read the history of housing discrimination, and we see this Federal Reserve, with you as Vice Chair, have not really stepped up. It is not just a moral issue. It is an economic one. According to the San Francisco Fed study, our economy has lost $70 trillion over the past 30 years because of racial inequities. We will continue to hold back our economic growth and competitiveness if we do not unleash all of America's potential.

Let me move somewhere else. You said that banks are in strong financial conditions, more liquid, better capitalized than a year ago, with $100 billion in loan loss reserves. Is that correct?

Mr. QUARLES. That is correct.

Chairman BROWN. Thank you. To me, it is why it is even more troubling that banks are fighting the $4 billion debt relief plan to Black and Brown farmers who, as you know, in your understanding of history of the Fed and history of the banking system and the financial system, those farmers have struggled to get loans and Government grants, for generations were systemically denied USDA loans that should have been granted. Banks are going to get back every penny of money they lent plus 20 percent on top of that. These USDA loans are guaranteed at 95 percent, yet banks are still fighting this. The only explanation I can come up with is that they will block anything that might cut into their profits even a cent.

Let me ask a second question. As big banks vie for competition and then close local branches, many rural communities are left 30, 40, 50 miles from a place to deposit a check or to get a small business loan. The Fed is responsible for approving bank mergers and consolidations, which have led to banking deserts across the country.

Do you agree the Fed has contributed to the loss of banks in rural areas?

Mr. QUARLES. No, actually, I do not. When we look at bank mergers, among the factors that we take into account, that we are required by statute to take into account and do so seriously, is the convenience and needs of the communities that are served by the merging institutions. And the closing of branches, where those are going to be closed, the plans for that are very carefully reviewed by us.

Chairman BROWN. Well, for the last decade, part of that time, right after you left the Bush administration and in your time with the Trump administration at the Fed, from 2019 we have lost 5,600 bank branches. Twenty percent of branch closings since 2010 have been the only branch in its census tract. The Fed's job is to make sure we have a strong banking system. That includes access—it includes the strength of local communities. It includes access to banking services. And we know if there is not a bank in the neighborhood, so often these are mostly low-income areas, both rural and urban, we know where people turn. They are much more likely to turn to an unregulated, high-interest-charging financial service entity.

My time has expired. Senator Toomey, you are recognized.

Senator TOOMEY. Thank you, Mr. Chairman.

As I mentioned in my opening statement, there are a number of troubling signs that the Fed is attempting to get into the business of environmental policy. As you know, Mr. Quarles, the Fed's regulatory role is to ensure the safety and soundness of the financial institutions that it regulates. Let me ask you a simple question. I think this is probably a yes-or-no answer. Are you aware of any banks that failed due to Superstorm Sandy, Hurricane Andrew, the California wildfires, or any other recent weather event?

Mr. QUARLES. No.

Senator TOOMEY. I am not either, and you can go back quite a ways, and it is hard to find. We have not been able to find it yet. So it is pretty clear to me that neither the warming of the Earth's temperature, which is occurring, nor severe weather events pose a threat to the stability of the financial system. As Larry Summers said last week, there seems to be an overemphasis of certain risks like climate change by central banks, and here is a quote attributable to Larry Summers. He said, and I quote, "in order to be relevant to something that is on political leaders' minds."

So my concern is this will ultimately come at the expense of monitoring the real risks, and the Fed should not be wasting time and resources on what is ultimately a political effort.

Let me move on to money market reforms. This past March, you said that the Financial Stability Board will be outlining proposals for further money market reforms. You made a reference to that in your opening statement. Presumably, the impetus for these reforms is market disruptions we saw last spring. Of course, as you know, many markets were disrupted. Even the Treasury market was disrupted, the repo market was disrupted. And it seems very likely that a factor that made things worse for money market funds was the presence of a 30-percent liquid asset threshold that triggered these mandatory fees and gates. These regulations, of course,

were meant to prevent runs, but ultimately it looks at those the had the opposite of their intended effect.

My question for you is: If we are going to propose any new regulations, shouldn't we first make sure we fix any flaws in the existing ones?

Mr. QUARLES. I do think that the existing regulatory framework has to be something that is looked at, and we are including that in the overall broad review of the issues that led to the money market fund issues last March.

Senator TOOMEY. All right. Good.

As you know, this week I sent letters to three regional Fed banks inquiring about what I see as a troubling veer into social policy topics. In particular, some of the banks have appeared to engage in an activity that I think can fairly be characterized as advocacy with respect to systemic racism, which is a very controversial idea that somehow American laws and institutions, including, I presume, the Federal Reserve, are inherently racist in their design. A big concern here is whether the Fed banks are operating well beyond their statutory mandate.

Would you agree that if regional Fed banks engage in partisan advocacy masquerading as research, that advocacy would harm the Fed's credibility and its trustworthiness as an independent and nonpartisan entity?

Mr. QUARLES. So let me say two things with response to that. The short answer is yes. At the Fed we have a narrow mandate. We have been given significant autonomy to pursue that mandate, and I think that that is important. But that means that we should stay within the lanes of that narrow mandate.

I do think that within that mandate, research into breaking down the effects of some of the large aggregate economic numbers, whether by geography, whether by different demographies, can be appropriate. But it should not cross the line into advocacy. It should be analysis.

Senator TOOMEY. Thanks. Last question: As you know, the Fed's QE has put capital pressure on banks, and you addressed that with a temporary measure, and I know you have indicated that there will be something more coming through. So you anticipate more permanent changes in the regulatory regime to recognize this capital pressure?

Mr. QUARLES. Well, we are looking at that now. I think our best estimate is that as the level of reserves in the system grows over the course of this year, we will see some of that pressure. There are a variety of ways one could address it. We are exploring them all. We have not decided whether it will ultimately be necessary or what we have to propose, but we are looking closely at it.

Senator TOOMEY. I hope you will. I will finish up, Mr. Chairman, but, Mr. Quarles, I do think the Fed is imposing this through its unusual activity, which is continuing inexplicably to me. So I do hope you will look to remediate that. Thank you.

Chairman BROWN. Thank you, Senator Toomey.

Senator Menendez from New Jersey is recognized for 5 minutes.

Senator MENENDEZ. Thank you, Mr. Chairman. I was very happy to see Acting Comptroller Hsu announce the OCC was revising the ill-advised Trump era Community Reinvestment Act rule. After

last week's OCC announcement, I hope to see a joint interagency CRA rulemaking by all three bank regulators. This is an important civil rights law that should not be enforced in a piecemeal fashion.

So, Vice Chair Quarles, have conversations begun among the agencies on how the Federal Reserve, the FDIC, and the OCC might align their regulatory efforts around the CRA?

Mr. QUARLES. We have throughout the CRA process. As you know, it has been the Fed's position and desire that we would end the process with a joint rulemaking. We have each shared the comments we have received on our separate processes, the OCC's rule, our Advance Notice of Proposed Rulemaking. We are all aware of the input that has come from that, and it remains our objective to see a joint rule.

Senator MENENDEZ. I appreciate it is your objective. The question is: Since there is a change at the OCC—I understand what you did before. The question is: Are you engaged now in an effort with the OCC to align yourselves?

Mr. QUARLES. Well, we are certainly talking with them, and obviously, the position of the OCC has changed and, therefore, our continuing engagement I think is likely to result in the objective we have always had. But we do continue to talk with them.

Senator MENENDEZ. Well, let me reiterate how critical it is for all three banking regulators to get to the same page when it comes to the CRA. It is especially important, having seen the disproportionate impact this pandemic has had on minority-owned businesses and communities. I have a sense that some of my colleagues would think that none of you have any role to play in terms of dealing with the great inequities in our society. I totally disagree with that. And certainly when you have oversight over the Community Reinvestment Act, this is a key tool to try to deal with some of the issues that we face today for which the CRA was originally created. So I hope you will all get together and adopt a unified rule that strengthens the original intent of the CRA, which has never mattered more.

Let me ask you, this month marks 10 years since the deadline for finalizing the incentive-based compensation rulemaking, the rule to ban practices that reward senior bank executives for irresponsible risk taking. In those 10 years, we experienced the London whale, the Wells Fargo fake account scandal, and most recently Credit Suisse involvement with Archegos Capital Management. All three instances of corporate malfeasance or mismanagement were tied to executive pay incentives in one way or another.

So was the Federal Reserve forced to take some regulatory action to the London whale and the Wells Fargo fake account scandal?

Mr. QUARLES. I guess two things I would say. Well, the London whale was before my time, and I am recused from the details of Wells. So those specific questions, I am not sure that I can answer, but I can certainly say——

Senator MENENDEZ. It is a simple question. It is not something that you have to recuse yourself. It is an acknowledgment of what the Reserve did, whether you were involved in it or not. My understanding is that there were regulatory actions, and so if there were, do you take my word for the moment—because my time is limited.

Wouldn't it be more effective oversight to help prevent these types of scandals from taking place in the first place?

Mr. QUARLES. We do in our supervisory engagement with the firms; that is an important element of it, their compensation arrangements, their incentive compensation practices. As you know, the incentive compensation rule is a joint agency rule that requires complicated joint agency negotiation, but the Fed does closely supervise compensation practices.

Senator MENENDEZ. Ten years. Ten years. I do not care how complicated the matter is. It does not take 10 years for great minds to get together to think about what is an appropriate way to deal with excessive compensation. I think preventing scandals and resultant consumer harm is more effective. The Federal Reserve along with other regulators have a tool in their arsenal to help curb this type of risky and irresponsible behavior. And yet after 10 years, the incentive-based compensation rule remains unfinished. That is unacceptable, and I will be pressing each of the regulators that come before us. It is about time to get this done.

Chairman BROWN. Thank you, Senator Menendez.

Senator Hagerty from Tennessee is recognized for 5 minutes.

Senator HAGERTY. Chairman Brown, thank you, Ranking Member Toomey, thank you for holding this hearing. Vice Chairman Quarles, it is great to see you again, and I appreciate your testimony today.

Vice Chairman Quarles, like my colleagues, I am concerned about the Fed's potential mission creep into regulating social policies. I was pleased with the strength that our financial sector has shown as we have navigated this pandemic. I feel that we have done very well. I was pleased with the Financial Stability Report that talks about the balances in loss mitigation programs in our largest banks being reduced. I think that is a sign of strength right now. And I really am concerned about increasing, you know, with unnecessary regulations new burdens on imposing social policies that we really are at a point in our recovery we should not be impeding banks' potential to return to prepandemic levels. I am sure you share those concerns.

Vice Chairman Quarles, you gave a speech at the end of last year where you talked about your thoughts on the evolution of bank supervision. In the speech, you noted that your goals at the Fed are to make our regulatory framework more efficient, more consistent, simpler, more predictable. And certainly driving all of that is a fundamental principle of regulation, making it more transparent.

You also noted that it is even harder for the Fed—and I agree with those principles completely. You also noted that it is even harder for the Fed to do that beyond the regulatory framework when you get to firm-specific supervision. I agree with that as well.

Last week—I would like to ask you about this—President Biden issued an Executive order. That Executive order encouraged financial regulators to detail their plans to incorporate climate-related financial risk into their regulatory and supervisory practices. Vice Chairman, how will this directive, which is well outside the Fed's mandate, how does this directive square against the principles that I think you so clearly articulated in terms of efficiency, confidence

building, simplicity, and transparency in our regulatory and supervisory framework?

Mr. QUARLES. Well, I would say two things in response to that. First, I do think that it is appropriate and, indeed, incumbent on us as Federal regulators to look at potential risks—climate change is a potential risk—and to come up with a data-driven analytical framework around that to guide our engagement with the banks and to ensure that the system is resilient to what we determine to be actual risks arising from it. We are in the early stages of doing that. We have developed a process at the Fed for establishing such a framework. I think that, as I say, it is not only appropriate; it is incumbent on us.

Also true is that our job is ensuring the resilience of the financial system, not advancing a particular view of climate policy. That is for the Congress, perhaps other agencies. It is not the job of the Fed or other financial regulators, and so we should remain focused on that approach to our climate change analysis as opposed to something broader.

Senator HAGERTY. Well, I echo Ranking Member Toomey's view that weather has historically not been a driving force in resilience for the banking system, and I do not believe this is a high priority that the Fed should be wasting resources on.

I would like to turn my questions to the next area, which is asset valuations, Vice Chairman Quarles. The recent Stability Report talked about asset valuations and acknowledged the fact that assets are high. We have talked about asset bubbles before. What it failed to mention was the impact of inflation, yet inflation, we just hit a 13-year high in terms of inflation. And I am quite concerned about the inflation that we are seeing in our system. I think it is being driven by excessive amounts of Government stimulus spending. We have got supply chain dislocations that are lending to this. We have got pent-up demand that lends itself to this. But we have a real concern about inflation. At the same time we have a tremendous amount of liquidity pumped into the banking system.

I want to understand your perspective on what the potential impact of all this liquidity and inflationary pressure is on the banking system today.

Mr. QUARLES. Well, it remains my view and the general Fed view that these pressures are most likely to be transitory. As you note, the most recent monthly inflation number was the highest since 2009, but after 2009 we did not experience durably high inflation, and I think it is still most likely that that will be the case here.

If we are wrong—and, of course, we could be wrong—I think we have the tools to address inflation before it becomes kind of a permanent part of the framework.

Senator HAGERTY. Thank you, Mr. Chairman.

Chairman BROWN. Thank you.

Senator Tester of Montana is recognized for 5 minutes.

Senator TESTER. Thank you, Chairman Brown, and I want to thank you, Vice Chair Quarles, for the work that you and your team have done at the Fed during this crisis. And I want to thank you for your collaboration and your work to truly keep the Fed independent. So thank you for that.

Look, there are many challenges we face through this pandemic and the economic implications that have resulted from this. There are also many challenges that existed before the pandemic that continue to remain. I have been concerned about small businesses and families in rural communities having access to capital and credit. We have talked about it before. And there is also a lack of affordable accessible housing across the country, and that problem has only gotten worse during this pandemic.

I am also concerned that there may be new or growing problems that are not getting the focus that they merit while we deal with this current crisis. This is something that we have visited about before and I think it is important to consider on an ongoing basis, and I am sure it is something that you do in this role as Vice Chairman.

So are there trends that you are seeing or problems that you are concerned about that we really should be focused on?

Mr. QUARLES. It is a broad question, so let me try not to filibuster away the rest of your time with a 5-minute answer. But let me focus on two things.

I do think that in our recent Financial Stability Report, you know, we looked at some of the financial issues that I think it is good for us to be focused on now. I do not put the financial stability risks as extremely high at the moment. I think they are moderate. But questions about asset valuation and the potential implications of that to the financial system are important.

One area where I am particularly focused both domestically and also in my international work as Chair of the FSB is on the regulatory framework for nonbank finance where I think we saw that there could be some improvements in that regulatory framework that would make the system more resilient for the next time it faces a shock like March of 2020.

Senator TESTER. I appreciate that. So as the communities and institutions that you regulate recover from the pandemic and the economic crisis, like many of the challenges we face now, how to address the recovery may look in different in rural community, frontier communities, than it does in more urban or suburban communities. So in your role, are you seeing differences in how different communities are recovering from this pandemic?

Mr. QUARLES. We are. There clearly are geographic differences. There are differences between urban and rural. To some extent, there are inevitably going to be—as you come out of an event like this, you know, there are differences in the speed of policy change, and that results in differences in geography. There are differences in—you know, some industries are concentrated in a particular geography, and they have greater supply problems than other industries.

It continues to be our expectation that over the course of the year, that will tend to even out, but there are clearly differences at the current moment.

Senator TESTER. OK. So are there things that we should be doing to help recovery overall? But dovetailing off the last question, too, are there things we should be doing to reduce the disparities between communities in their recovery? So both those questions:

overall globally, and is there something we should be doing different in other communities?

Mr. QUARLES. Yeah, I would say from the point of view of the Federal Reserve, you know, I think our use of our tools to address this is if we ensure that the recovery proceeds as smoothly as possible, we will get to the other side of it and that evening out faster. I think our tools do not lend themselves particularly well to, again, geographically or demographically targeted solutions, and that our job is best performed in ensuring that the overall economy is moving in the right direction as fast as possible.

Other more targeted solutions are the realm of Congress, and I would not presume to tell you what you should or should not do there.

Senator TESTER. We always appreciate your input. Anyway, thank you very much.

Thank you, Mr. Chairman. Thank you, Vice Chair.

Chairman BROWN. Thanks, Senator Tester.

Senator Tillis of North Carolina is recognized for 5 minutes.

Senator TILLIS. Thank you, Mr. Chair, and thank you, Chair Quarles, for being here today. And thank you for your time over the years. I find you to be highly accessible, and I appreciate the time we spent talking just this week.

I want to get back to something that we discussed, and it relates to the MRAs and MRIAs that the Fed supervisors send to financial institutions. Those are matters requiring attention really reflecting potential issues supervisors find.

I understand a lot of that information is designated as "confidential supervisory information." What I believe that means is that when they receive an MRA or MRIA, they are really prohibited from disclosing that information to anyone, including their elected representatives. I see a problem with that. For all intents and purposes, that puts a Fed supervisor in a judge, jury, and executioner role, and I think that the supervisory decisions can limit a company's dividend, their business decisions, their hiring decisions, and pretty much any business action. Even if they disagree, they do not really have any recourse. That seems problematic to me. I know you are a lawyer, and I am not, but it seems like this is pretty foundational.

I guess the question that I have is why the Fed would need to self-impose this requirement and why is it that the banking institution does not have the flexibility to share information that may be in a confidential supervisory letter, but to share that information and advocate in instances where they disagree with the supervisory position. And, more importantly, where in the law does the Fed have this authority to impose this restriction on financial institutions?

Mr. QUARLES. So I think there are a number of fair points there. First, you know, the due process guardrails around our supervisory activities I think are important. As you know, I have made that a theme of mine at the Federal Reserve that we need to think more carefully than we have in the past about how to impose those. Transparency is important in supervision as well as in respect to work with regulation.

Now, the Federal Reserve Act and other banking statutes do acknowledge, they have historically acknowledged, that there can be concerns with the disclosure of supervisory information, even by the affected firm, which can lead to contagion to other firms. It can be misunderstood. It can cause, you know, a perception that there are greater problems at a firm than there are, depending on how a particular action may have been worded, understood between the supervisor and the firm, and perhaps susceptible to misinterpretation.

So we have historically been cautious about the release of individual firms' supervisory information, including by those firms. But we are trying to become more transparent about it. In the supervisory report that we delivered to you today or have delivered in the past, we discuss sort of in the aggregate MRAs, MRIAs, what they deal with, the number of them. So we are trying to increase transparency around that to allow this sort of discussion and engagement without crossing the line into, you know, potential risk to individual firms from disclosure of their CSI.

Senator TILLIS. But wouldn't it make sense that if there was a potential risk to an individual firm, they themselves would not want to disclose that and work with the Fed? I am talking more about issues that an institution may disagree with. It seems like right now they have a gag order on even talking about that. And I do not really see anything that provides them with due process, mainly because I do believe in the judge, jury, executioner sort of context that they are operating in now.

So what could we do to put meat on the bones of the concept of transparency when all the control is in the control of the Fed or the Fed supervisors?

Mr. QUARLES. So I think, you know, I do not have an answer for that today. That is something that I have given thought to. These are practices that have attained for decades, really. They have become more important in recent decades with the expansion of the supervisory activities, and, you know, I think that we should be paying more attention to it at the Fed as to how to square that circle.

Senator TILLIS. Thank you. I look forward to continuing to keep an intense focus on this. And I also want to thank you for a lot of the regulatory reform that you did to kind of ease the burden on the industry. I believe that you have played a very important role in doing that, and I wanted to thank you publicly for it.

Thank you, Mr. Chair.

Chairman BROWN. Thank you, Senator Tillis.

Senator Warner from Virginia is recognized for 5 minutes. And, Senator Warner, I am going to go slip into the Finance Committee as you do, and if you would next either call on Senator Lummis, if she is there, or Senator Cortez Masto if there is no Republican here. If you would do that, thank you.

Senator WARNER [presiding]. Thank you, Mr. Chairman.

Vice Chairman Quarles, it is great to see you again. I want to raise a couple subjects that I know we have talked about in the past. One is we know over the last year with COVID we have seen disparate economic effects. Particularly communities of color have been hard hit; particularly women-owned businesses have been

hard hit. One of the things that we have talked about in the past is a relatively small piece of the financing sector, but one I think that has great potential to grow is CDFIs, community development financial institutions. I worked with folks on this Committee, including Senator Crapo last year, and we got a $12 billion commitment to both do grants and Tier 1 capital into these CDFIs. I am happy to see Treasury rolling that out. The Fed also obviously has a role here in terms—and I know Senator Brown raised this in terms of CRA activities.

We also saw during the pandemic that the Federal Reserve's Paycheck Protection Program Liquidity Facility helped produce some liquidity relief to CDFIs. I would like you to speak to that and, you know, on a going-forward basis how we can not only help CDFIs but also even community banks that may be trying to lend into some of these disadvantaged communities that has been tough to do in the past.

Mr. QUARLES. Certainly. Thanks, Senator. Well, we do have a very active program with respect to CDFIs as well as MDIs. We are working with the Treasury in the Emergency Capital Investment Program. That provides capital directly to CDFIs as well as MDIs. The Fed as well as the OCC and the FDIC released a rule in connection with that program to help implement the assistance by giving regulatory capital treatment for instruments that are issued under the program. We have provided a set of frequently asked questions on our website so that CDFIs can be better aware of how to take advantage of it. We host regular Ask the Regulator sessions.

Senator WARNER. I know you are kind of going through the—I hope we can keep working on this, and, again, a topic that I will not ask you to comment on today, but I try to keep familiarizing my colleagues with—you know, we have been working on, I think, a very interesting proposal that for first-generation homebuyers—and, again, that would help people across all demographic backgrounds—a mortgage product that would include an interest rate subsidy that would have the homeowner in a sense pay the same normal amount they pay on a 30-year mortgage, but they would actually be obtaining a 20-year mortgage. The ability of wealth building literally doubles if you have a 20-year mortgage versus a 30-year mortgage. And when we are looking at a wealth gap that is basically 10:1 between Black and White families, 7:1 between Latino families and White families, if we can build more equity on a quicker basis for homebuyers, I would ask my colleagues to trust me on the math on this. More to come. But I do want to keep raising this and, again, hope we can get broad, bipartisan support as we get more details.

I apologize about my little commercial there. I know we have discussed this, and I think you are intrigued on how we can do something that would not drive up the cost of the real estate or drive up the pricing when we have such short supply, but actually might address some of the wealth gap issues.

In my last 50 seconds, I just want to raise the issue of cryptocurrencies. I mean, we have seen the EU come forward with a fairly broad-based report on crypto. I see some value in distributed ledge, but the volatility amongst some of these entities con-

cern me. I see some of the illicit use from my role on the Intel Committee.

Can you speak to this? What else do we need to give you and the other regulators to get this under some semblance of order?

Mr. QUARLES. Well, we, along with the OCC and the FDIC, are engaged right now in what we are calling a sprint in seeking to pull together views on exactly that, on a common regulatory framework, the capital treatment, the operational treatment. And in the course of that, if there are gaps in the regulatory framework, we will also make those known.

Senator WARNER. I look forward to continue working with you. I think we do need to get a structure here.

I do not know whether I am—calling a Republican colleague, is Senator Lummis or Senator Rounds here? If not, I am going to——

Senator LUMMIS. Lummis is here.

Senator WARNER. OK. Senator Lummis, please.

Senator LUMMIS. Thanks, Senator Warner. And welcome to the Committee, Mr. Quarles. I am delighted that you would join us today.

There have been concerns in Europe that Basel III's net stable funding ratio requirement might cause changes or adjustments for certain commodity markets, including gold. My question is: Do you see any concerns in the United States about this? And how can we ensure the July 1 deadline makes a smooth implementation date?

Mr. QUARLES. So I would say that we have not seen evidence currently of that phenomenon in the United States as we approach implementation of the NSFR. Now, we have provided a long runway toward implementation of the NSFR. We had a very comprehensive comment process in the United States. We took account of many of those comments in implementing our final rule, and we provided a lot of advance notice to firms as to how to prepare for it.

So I do think that we have done a fair bit to ensure that that transition is smooth.

Senator LUMMIS. Thank you. I am going to switch over to the project that Wyoming has done to complete its regulations and bank examination manual for digital assets. It covers issues like digital asset volatility risk, money laundering and sanctions requirements, custody, digital asset receivership, and capital standards.

Can you provide an update on the FFIEC and Federal Reserve's work toward the creation of a supervisory framework for bank digital asset activities?

Mr. QUARLES. The OCC, the FDIC, and the Fed are working together, again, in what we have been calling a "sprint," so over a relatively concentrated period of time to pull together all of our work in digital assets and to have a joint view, a joint framework for their regulation and supervision practices with regard to them.

We are in the middle of that or actually in the early stages of the sprint, so it would be premature for me to tell you where that is going to turn out. But this is something that is a high priority not only as a matter of importance but as a matter of chronology, and we expect to be able to give at least some results from that soon.

Senator LUMMIS. Well, while you are doing that, I want to refer you to the work that Wyoming has done. The Wyoming Division of Banking has done this securities examination manual. It has done this special purpose depository institution custody and fiduciary examination manual. It has done the SPDI Bank Secrecy Act anti-money laundering, asset control examination manual. It has done this risk examination manual. It has done the BSA/AML FEC compliance for these. It has done the examinations manual. It has done the information security for SPDIs. It has done the payment system risk compliance here. We have got 771 pages of ways to assist you in understanding all of the hard work that Wyoming has done to provide a template for your good work. So I just want to point out that you have a good road map in front of you for future reference.

Mr. QUARLES. I appreciate that, and I hope that when we are done, we have something that is nearly so comprehensive.

[Laughter.]

Senator LUMMIS. Wonderful. Thanks.

Could you comment on the positive role of community banks in providing credit during the pandemic, especially facilitating the Paycheck Protection Program and especially in rural States like Wyoming?

Mr. QUARLES. Community banks were essential in the PPP program. They were a critical part of the distribution mechanism, in part because of their broad reach into their communities and their sort of deep knowledge of particular customers. I think it would have been difficult for the PPP program to have worked without the participation of the community banks.

Senator LUMMIS. Thank you, Mr. Chairman. You have hit the 5-minute nail on the head. I appreciate your appearing before the Committee today, and I yield back.

Senator WARREN. All right. I think that means that I am up next, so I will go ahead and get started.

Last month, a hedge fund called "Archegos" imploded after making some very risky bets, and some of our biggest banks had loaned Archegos the money to make those bets, even though the hedge fund was managed by a guy who had already been charged with insider trading and banned by regulators from handling clients' money.

Now, those banks suffered $10 billion—that is billion—in losses as Archegos collapsed with more than half the losses hitting one bank in particular—Credit Suisse.

So, Vice Chair Quarles, your job at the Fed is to oversee the safety and soundness of our banks, and last year you made the decision that Credit Suisse and a few other big foreign banks no longer should be required to participate in a Fed program that was designed to oversee the riskiest banks, the Large Institution Supervision Coordinating Committee, or LISCC. Is that right?

Mr. QUARLES. Yes, although it did not change the intensity with which——

Senator WARREN. So you are the one who said we are not going to do that. So at the time you justified dropping these banks from increased supervision on the ground that these banks—and I have it here—"have significantly shrunk their U.S. footprint, and their

U.S. operations are much less risky than they used to be." Your time, of course, was impeccable on this. Just a few months later, Archegos blew up and resulted in billions of dollars of losses to Credit Suisse.

So now, Vice Chair Quarles, before you told the banks like Credit Suisse that they did not need extra scrutiny from regulators, before that, did you see any warning signs that these banks had some deficiencies in their risk management?

Mr. QUARLES. Well, the losses that you are referring to, the great bulk of the Archegos losses occurred outside the United States. State-funded——

Senator WARREN. Are you saying that losses outside the United States can affect operations inside the United States by these large multinationals? Surely not.

Mr. QUARLES. But we do not supervise their operations outside the United States, so their operations within the United States have shrunk exactly as I said.

Senator WARREN. So you are going to stick with your original play. You know, in 2019, back when Credit Suisse was subjected to the Fed's stress test, the Fed "identified weaknesses in the assumptions used by the firm to project stress trading losses that raised concerns about the firm's capital adequacy and capital planning process." In plain English, the Fed said that Credit Suisse's models just were not realistic.

So I want to put the timeline together here. In 2019, Credit Suisse fails a test because it cannot accurately project its trading losses. In 2020, you, Mr. Quarles, decide that Credit Suisse should be subject to weaker supervision. And in 2021, a headline shows up in the *Wall Street Journal* that reads, "Credit Suisse had surprise $20 billion exposure to Archegos investments."

So let me ask this: Mr. Quarles, do you now agree that you made the wrong decision to weaken supervision for a bank like Credit Suisse?

Mr. QUARLES. Senator, we did not weaken the supervision of a bank like Credit Suisse. The civil servants who are supervising Credit Suisse and a large bank and foreign bank operations——

Senator WARREN. Wait, you took out of the program——

Mr. QUARLES. ——would take issue with you——

Senator WARREN. I am sorry. You cannot just say——

Mr. QUARLES. ——LISCC supervisors.

Senator WARREN. You took out of a program that was designed to have it enhance supervision, say you did not need the enhanced supervision. That is what you said at the time, because their footprint in the United States had shrunk.

Mr. QUARLES. I did not say it was supervision, ma'am. I said it was more appropriate to supervise them with other foreign banks of the same size footprint in the United States, which is what we do. Other foreign banks with similar prime brokerage operations that have long been supervised outside of LISCC because their footprint in the United States is smaller. These banks are now smaller. The losses that you are referring to did not occur in the United States——

Senator WARREN. I have to say that——

Mr. QUARLES. ——we would not have been able to pick them up in LISCC or otherwise.

Senator WARREN. ——I am stunned by your argument that you want to say that there was no warning sign from the fact that $10 billion in losses could have affected what Credit Suisse was doing here in the United States. Look, we dodged a bullet with the Archegos collapse this time. But what slipped through the net by regulators to contain these losses when things go wrong was relatively small to what could have slipped through. It could have been an even bigger failure, and that is because instead of protecting the system, you spent your time at the Fed cutting holes in the safety net anytime you could. Your term as Chair is up in 5 months, and our financial system will be safer when you are gone. I urge President Biden to fill your role with someone who will actually keep our financial system safe.

Thank you.

Chairman BROWN [presiding]. Thank you, Senator Warren.

Senator Van Hollen from Maryland is recognized for 5 minutes.

Senator VAN HOLLEN. Thank you, Mr. Chairman, and thank you, Vice Chairman Quarles.

Let me start by associating myself with the comments of Senator Mark Warner with respect to CDFIs and MDIs, and I know this is something the Chairman and many of us have been working on.

I also want to commend the Fed for moving forward on the real-time payment system. I thought it was too late in getting started, but I am glad you are all working to try to make up for some lost time. I see that a pilot program will be launched later this year and that the full rollout date is now schedule for 2023.

Two questions on other issues. First, on the issue of central bank digital currencies, I am glad to see the Fed moving forward with issuing a report on central bank digital currencies that will include public input and that the Fed hopes to play a "leading role in the evolution of international standards." I do not think we can afford to have the United States fall too far behind on this measure, especially given China's moving ahead with their own pilot program. I recognize that there are lots of issues. Can you tell us more about where we are in researching and developing—can you tell me whether or not the Fed would have existing authority to launch a pilot program if it so chose? Or do you believe you need congressional authority to do that?

Mr. QUARLES. Well, so as you have noted, we are beginning a process—Chair Powell announced it last week—of doing a very deep and comprehensive study of sort of the potential of the issues around central bank digital currencies in the United States. As you noted, there are a host of issues.

I think it would be—I think ultimately what that study will lead us to is to a conclusion as to whether a CBDC is appropriate for the United States. I think, you know, that is very much an open question currently.

As to whether we have the authority to implement a pilot program or to implement a CBDC, I think that depends on how the structure of the CBDC is—on how we structure it. There are certain structures that we could perhaps do under current authority,

but most of the types of CBDC that are discussed would require additional legislative authority to actually use.

We are engaged in a pilot of sorts of testing out the technology around CBDC with MIT. Currently the Boston Fed and MIT are working on this technology pilot. But a broader pilot and certainly a CBDC itself is most likely to require additional legislative authority.

Senator VAN HOLLEN. Well, I would appreciate it if you or your colleagues can get back to me on exactly what additional authority you would need to do a more expansive pilot program or move forward with the full decision.

Let me ask you about the issue of the Fed's efforts to take into account the risks of climate change. I was glad to see the Fed recently created the new Supervision Climate Committee to strengthen its capacity to identify and assess financial risks from climate change and a Financial Stability Climate Committee as well.

Mr. Quarles, when can we expect to see the Fed's framework on climate change or any recommendations, reports, or deliverables that will be the product of these two committees?

Mr. QUARLES. Well, I cannot give you a timeline today on, you know, when we will have a sort of publicly available framework for comment. I can certainly commit that we will be very engaged in that process of getting public input, getting input from Congress on our thoughts, and that it is important that we develop a framework promptly and one that is based on data and our own experience.

Senator VAN HOLLEN. Well, Senator Schatz and I and some others are moving to introduce the Climate Change Financial Risk Act, which we introduced last Congress. We will be reintroducing it to establish a group of scientists and economists to look at these issues and hopefully inform your decisions.

You agree that the standardization on climate risk data will be important from a supervisory perspective, in other words, to develop clear standards so that we can compare apples to apples in this conversation?

Mr. QUARLES. Yes, I do.

Senator VAN HOLLEN. Well, thank you, and I do look forward to hearing from you with respect to a little better idea of when we can expect those recommendations from those two reports. Thank you.

Thank you, Chairman Brown.

Chairman BROWN. Thank you, Senator Van Hollen.

Senator Cortez Masto from Nevada is recognized for 5 minutes.

Senator CORTEZ MASTO. Thank you, Mr. Chair. Vice Chairman Quarles, welcome. It is great to see you again.

Let me start with an issue around the unbanked population. So the latest FDIC report shows that 6.3 percent of the population in Nevada is unbanked, and as the Federal Government continues to allocate assistance from the American Rescue Plan, such as child tax credits, what steps can the Federal Reserve take to ensure that more individuals have access to bank accounts and financial services in order to receive this assistance?

Mr. QUARLES. So I think that, you know, as you have noted, COVID has shown some of the specific ways, has highlighted some of the specific ways in which the unbanked are disadvantaged. And we do participate in a number of efforts to try to increase the num-

ber of citizens with bank accounts. We include that in our CRA evaluations of banks as to whether the efforts that they are taking to ensure that all the members of their communities have access to bank accounts at those institutions. And we participate in something called "BankOn", which is a program with the banks to promote access to standardized, very low cost transaction accounts for all Americans, particularly those who are unbanked.

Senator CORTEZ MASTO. Thank you. Vice Chair Quarles, in your testimony you call for, and I quote, "further review . . . of changing patterns in the use of financial services, by consumers and businesses; and a changing relationship between banks and their nonbank partners."

Can you further elaborate on that? Are you talking about what I have heard earlier in conversation about fintech or cryptocurrencies or the unbanked? What are you thinking there? Because you are right, the consumers and businesses are going to be driving this, and I am curious what the Fed's review looks like in this space.

Mr. QUARLES. Yes, well, the short answer is all of the above. You know, technology, a variety of forms, whether that is partnerships between banks and fintech firms where the fintech firms provide consumer interface principally and the banks provide the plumbing, or in some cases fintech firms are seeking to operate without banking partners and what the potential implications for that are. In some cases, they are able to operate more cheaply. Perhaps that can be a tool to address inclusion. But it raises issues for how we think about the supervision of those firms.

There are other aspects of technology where you have got sort of very large tech firms that are increasingly providing services to the banking industry and how do we supervise the operational and potential financial stability risks associated with those relationships when historically our traditional focus has been on the banks. We have the authority under something called the "Bank Service Company Act" to examine these third-party firms, and we need to work through a framework as to exactly how we would do that more robustly as these relationships grow.

Senator CORTEZ MASTO. Well, thank you, and it is a big task, and I understand that you talked about ensuring the stability, safety, and soundness of the market as well. I get that. To what extent do you bring in consumer protection? Is that part of what you are looking at as well as the Fed to ensure from the business and consumer perspective that there are protections in place?

Mr. QUARLES. Very much so. As we look at issues like the use of artificial intelligence, either by banks or by fintechs, you know, assuring that these various technologies do not exacerbate risks to the consumers, that they are being operated with that in mind, is something that we are very focused on.

Senator CORTEZ MASTO. And then, briefly—I have got about 40 seconds left—how is the Federal Reserve considering stress testing to assess how prepared individual firms and the overall system are to respond to and recover from systemic cyberevents?

Mr. QUARLES. So we do run tabletops, and we do not really run what we would call "stress tests" there to determine capital charges associated with potential cyberevent risk. But we do—you

know, we are very heavily engaged with the firms on their cyberexposure.

Senator CORTEZ MASTO. Thank you. Thank you for being here today.

Chairman BROWN. Thank you, Senator Cortez Masto.

I am not sure if Senator Moran is available? Then Senator Ossoff from Georgia is recognized for 5 minutes.

Senator OSSOFF. Thank you, Mr. Chairman, and thank you, Mr. Quarles, for your service and for your testimony today.

What do you assess to be the most significant risks to macroeconomic and financial stability and growth over the next 2 to 4 years?

Mr. QUARLES. So I would begin by saying that I think that the overall risks to stability, to financial stability, are only moderate. I do not think that we are in an era of especially large risks to financial stability currently. I think that the COVID event has highlighted that, at least to my mind, the particularly risks lie largely in the improvements that can be made to the regulatory framework around nonbank financial institutions and the potential exposure of nonbanks in the financial sector to be a source of instability. Again, I do not think that risk is large currently, but I think that that is certainly what I am focused on, particularly in my international work.

Senator OSSOFF. At what corners of capital markets and the financial services industry do you think regulators lack sufficient visibility to make informed decisions about risk and whether their authorities are sufficient?

Mr. QUARLES. So that is a good question. Do we need additional data? Obviously, most of our data certainly at the Federal Reserve comes from our supervision of the banking system. For the most part, I would say that our supervision of risks in the nonbanking system, the information that we get from the banking system's relationship with the nonbanks has been adequate for us to be able to judge risks in the nonbank sector. But, obviously, we do not get that information directly from those firms, and there are cases where there are data gaps from the nonbanking sector as to the exact state of the risks that they face.

Senator OSSOFF. Thank you. As the Federal Reserve contemplates its posture moving forward with respect to interest rates and quantitative easing, how is labor force participation, the predictable disruption to labor markets that has resulted from this pandemic and which persists today, and the dynamics in labor markets unique to this shock and this moment, how does that affect your and your colleagues' reading of the strength of the labor market, the unemployment rate as you contemplate potential changes to your posture targeting unemployment, price stability, and fulfilling your mandate?

Mr. QUARLES. So as you know, we revised our monetary policy framework particularly in how we think about these labor market issues, labor market strength measures, relative to when we think it is appropriate to begin withdrawing accommodation and to say that we really need to see the data coming through on improved employment numbers before we would—you know, before we think it is—we will wait to see that data, whereas in the past we might

have said based on our projections, we expect to see that data. And in order to remain ahead of the curve, we will act now even before the actual employment figures improve to where we think they are going to be in, say, a year.

Our experience over the course of the last decade has shown that when we had that slower reaction function, when we allowed employment to improve, to continue to improve past what would have been our traditional measures of a level of unemployment that would have accelerated inflation, that we did not get inflation, and we had significantly improved employment outcomes. I am a person who believes that we should listen to the data, we should believe it, and so we will wait to see that actual data before making some of the moves that we would have made sooner in the past.

Senator OSSOFF. Thank you, Mr. Quarles. I have got just 20 seconds left, but if you could please comment on the financial situation of households in the lower quintile in terms of wealth and income, what do you think are the structural impediments to improvement in the financial condition of low-wealth and low-income households? And how much progress have we made over the last few months, please?

Mr. QUARLES. Well, I think the principal impediment is an improved economy, and I think our job at the Fed is to continue to provide support for a rapid recovery of the economy, which will help all demographies.

Senator OSSOFF. Thank you, Mr. Quarles.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Ossoff.

Senator Warnock we believe is on his way. Senator Moran's office is still on the screen. Let me run through and make sure anybody that might want to ask questions and has not yet, on the Republican side, Senators Shelby, Crapo, Scott, Rounds, Kenney, Moran, Cramer, and Daines. And on the Democratic side, Senators Reed, Smith, Sinema, Warnock. And Senator Moran has just returned. Senator Moran, you are recognized—your camera just went off. Senator Moran, you are recognized for 5 minutes if you can stay and do that.

Randal, as you know, this is a little different time to do these hearings this way.

Senator Moran, you are recognized for 5 minutes.

Senator MORAN. Yes, I am on. Chairman, thank you very much. Mr. Quarles, thank you for your presence today and your service on the Federal Reserve Board of Governors.

I want to talk about Basel III. You stated that implementation of the so-called Basel III end game is a priority item for rulemaking proposal for public comment expected later this year. Would you provide the Committee with your perspective on how best to maintain the tailoring rules recently implemented?

Mr. QUARLES. Well, tailoring the regulatory framework will remain a principle that we have in mind as we come out with proposals to implement the final pieces of Basel III, of which the most important are the capital charge for operational risk and what we call the "fundamental review of the trading book" or a capital charge for trading risk.

For the most part, I do not think those—you know, I think those rules will in many cases tailor themselves. They are addressed principally to larger firms, but we will certainly have in mind the principles of tailoring that we have used in our regulatory work over the last 4 years, and that we used in implementing S. 2155.

Senator MORAN. Mr. Quarles, let me see if I can build on that. Despite some objections that the Fed has been gutting Dodd–Frank and putting financial stability at risk with the recalibrating of its regulations and supervisory framework during the past few years, over the past year the banking system has proved to not only be incredibly resilient but one of the primary sources of strength in the U.S. economy. Would you expand on why right-sizing of regulations proved effective over the past year and how we should go further in those efforts? And I am really talking about response to COVID and the challenges of our economy. We have come through this pretty well in that sense, and what are the lessons learned, and what do we need to be doing in the future?

Mr. QUARLES. Yes, well, I think the lessons learned in the most fundamental sense are that we did have a strong banking system, that we had a banking system that was able to support the real economy. It served as a source of support for the real economy; that the measures that were taken both post the financial crisis and improving capital and liquidity, and to make that framework more efficient over the course of the last 3½ years, both worked together to create a strong regulatory environment for that to attain.

Senator MORAN. Thank you very much.

Mr. Chairman, thank you for the opportunity to question.

Chairman BROWN. Seeing no one else ready to testify, w will close the hearing. Thank you, Vice Chair Quarles, for being here today and providing testimony.

For Senators who wish to submit questions for the record—ah, Senator Warnock is on. Senator Warnock from Georgia is recognized for 5 minutes. Ready or not.

Can you hear? Senator Warnock, you are recognized for 5 minutes.

Senator WARNOCK. Hello. Can you hear me now?

Chairman BROWN. There we go. Yes, we can hear you perfectly. Thank you.

Senator WARNOCK. Great. Thank you, Chairman Brown. And, Mr. Quarles, thank you so very much for being with us.

The Community Reinvestment Act addresses how banks must meet the credit and capital needs of the communities they serve. Congress, of course, passed the CRA, as you know, in 1977 in response to real problems, like redlining, a practice by which banks discriminated against prospective customers based primarily on where they lived or their racial/ethnic background rather than their actual creditworthiness.

So the CRA not only addresses a harmful legacy of discrimination in lending, but also racism and bias in our current lending system that harms communities and blocks wealth-building opportunities. So I was happy to hear about last week's decision by the OCC to halt implementation and reconsider its controversial CRA rulemaking, which started under the previous Administration. This

proposed rule would have watered down this important civil rights era legislation and harmed many working-class communities.

Vice Chair Quarles, the Fed also has oversight authority over the CRA and was notably absent from last year's rulemaking. Do you believe a joint CRA rulemaking with the Fed, OCC, and FDIC is important to ensure we do not leave our most vulnerable communities behind?

Mr. QUARLES. Yes, Senator, I think it is both important and desirable and achievable for our three agencies to have a joint rule and approach on the CRA.

Senator WARNOCK. So will you commit to working with the OCC and the FDIC to issue a joint CRA rulemaking?

Mr. QUARLES. So we are certainly working with them to do that. That has long been our stated goal. You know, we are regularly talking with them. As you know, Senator, the Fed put out its own Advance Notice of Proposed Rulemaking with our own sort of CRA improvement framework. We are sharing the information that we have gained from that process with the OCC. The OCC is sharing the comments that they got during their process with us. The three agencies are engaged in joint discussions. It does remain very much our objective, and as I say, I think it is achievable for us to have a joint rule.

Senator WARNOCK. I agree, and I think it is much more important for us to get the reform right than to do it quickly, and so I am hopeful that you will gather feedback from broad and diverse stakeholders to make sure that we get a joint rule and make sure that we get the CRA reform right.

Thank you, Mr. Chairman. I am going to defy Baptist preacher gravity and close with 2 minutes left.

Chairman BROWN. Well, no Baptist preacher I have ever listened to. Thank you, Senator Warnock.

Thank you to the witness, and, Senator Warnock, just for your information, we will follow up with you on that CRA. That is really important. We have been talking to all three regulators, and Senator Warnock is right on exactly where we want to go on that. So thank you.

Thank you, Mr. Quarles, for being here today and providing testimony.

For Senators who wish to submit questions for the record, those questions are due 1 week from today, Tuesday, June 1st.

Vice Chair Quarles, based on the change made to our Committee rules, you have 45 days to respond to any questions. Thank you again.

With that, the hearing is adjourned.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF CHAIRMAN SHERROD BROWN

A year ago today, we watched for 8 minutes and 46 seconds as police murdered George Floyd, and across the country, we saw Americans demand justice for the killings of too many Black and Brown Americans and an end to systemic racism in our country.

And over the past year, the pandemic has taken half-a-million American lives, wreaked havoc on small businesses, pushed families into foreclosure or eviction, and forced millions of workers—many women and workers of color—out of the workforce.

For most Americans, it's been a very long and difficult year. A year that revealed what many of us already knew—that even before the pandemic, our economy wasn't working for most people.

I've heard some people, including many of my conservative colleagues, say that we had the best economy in our lifetime before the coronavirus hit. Those people need to follow Pres. Lincoln's admonition to get their public opinion baths.

It certainly wasn't the greatest economy for most people in Senator Toomey's hometown in Rhode Island, or my hometown of Mansfield.

Workers' wages have been flat for decades. Jobs continued to move overseas. In my hometown, companies like Westinghouse, Fisher-Body, Tappan Stove, Mansfield Tire closed down, one after another, and thousands of good union jobs disappeared.

And they weren't replaced by new investment—the "creative DEstruction" the market fundamentalists like to talk about wasn't followed by any CONstruction, creative or otherwise.

Yet corporate profits continue to climb and CEO pay has soared.

Those outcomes are of course connected.

Corporations lay off workers or cut pay and benefits to juice their stock price. Companies close down factories and move good-paying union jobs abroad to cut costs. Big banks keep getting bigger, fueling the concentration of corporate power in every part of our economy—from agriculture to health care to manufacturing.

The economy of the past few decades may have looked good from the big windows of corporate board rooms looking down on Wall Street—or from the Dirksen Senate Office Building.

But the economy hasn't looked great in a long time when looking out from the small towns and rural communities that the big banks have left behind in search of higher profits. It's never looked all that great for the Black and Brown families who lost their homes and wealth in the wake of the Great Recession, barely getting back on their feet before the next crisis hit.

When I talk to Ohioans, I hear a constant refrain: people don't trust banks, especially the biggest banks. They've been burned by predatory mortgages, high overdraft fees, and expensive second chance accounts.

They've watched Wall Street reward themselves, despite scandal after scandal. They remember how Wall Street bounced back after they wrecked our economy. They know Washington allowed that destruction to happen. And they certainly remember that taxpayers were forced to foot the bill.

Tomorrow, for the first time ever, we will bring the CEOs of the six largest banks in the country to testify before this Committee. Our job is to hold accountable the institutions that for too long have had outsized power in our economy—power that only continues to grow.

Today, we'll hear testimony from the Federal Reserve's Vice Chair for Supervision—the person responsible for supervising those banks.

Mr. Quarles, checking Wall Street's power is supposed to be your job too.

It's your responsibility to enforce the law and to hold banks accountable for their misdeeds with meaningful punishments—not slaps on the wrist. Not paltry fines that don't make a dent—for gargantuan Wall Street firms, a fine is just the cost of doing business.

It's your job to stand up for the people who don't have corporate lobbyists, who don't make millions of dollars a year, and who don't get bailouts.

But as far as I can tell, you don't view standing up to Wall Street as part of your job. You have rolled back rule after rule—rules that are supposed to be a check on the power of the biggest banks, and supposed to ensure they invest in the real economy—not themselves.

Instead of investments in job creation and wages and new technology, they continue to pour all their extra cash into riskier and riskier bets, and buying back more of their own stock.

Good for them—but not so good for America.

We need—and you need—to bring the focus back to the people who make this country work.

We need—and you need—to make sure banks are taking into account climate risk. We need—and you need—to make sure that volatile, unregulated cryptocurrencies don't crash the economy and harm consumers.

We need to make sure workers' wages keep up with the cost of living—housing, childcare, prescription drugs, all the expenses that have been rising for decades now.

We need to close the racial wealth and income gap that keeps getting wider and wider.

It's our responsibility to work on solving these problems—not for the biggest banks, but for the people we serve.

If we want an economy that reflects our values, we can't let Wall Street write the rules—or tell the regulators how to do to their jobs, for that matter. Our financial watchdogs shouldn't be doing favors for the biggest banks.

You work for the American people, and I want to hear how you are going to stand up for workers and families and help create a better economy that works for everyone.

PREPARED STATEMENT OF SENATOR PATRICK J. TOOMEY

Thank you, Mr. Chairman.

Congress has provided the Fed with a great deal of independence to isolate it from political influence. However, Congress also gave the Fed narrowly-defined monetary and regulatory missions.

In the regulatory domain, the Fed has the authority to ensure the safety and soundness of the financial institutions that it regulates. But it doesn't have the authority to seek out and address political or theoretical risks in the distant future.

The Fed's recent actions raise concerns that it's losing sight of this constraint. Consider its increasing focus on the supposed risks of global warming to the financial system. In March, John Cochrane, a distinguished economist at Stanford, powerfully argued before this Committee that "climate change poses no measurable risk to the financial system."

Put simply, neither the warming of the Earth's temperature nor severe weather events are a threat to the stability of the financial system. Experience bears this out. In the last 11 years—a time period that included four of the five costliest hurricanes in U.S. history—we haven't found one bank failure caused by any weather event. In fact, we're not aware of any bank failure in the modern era due to weather.

Nevertheless, the Fed recently joined the Network of Central Banks and Supervisors for Greening the Financial System. The network's stated aim is to use financial regulation to "mobilize mainstream finance to support the transition toward a sustainable economy." In other words, to direct credit away from the fossil fuel sector.

Such actions are inconsistent with the Fed's mandate and authorities. As Chair Powell himself has said, "society's broad response to climate change is for others to decide—in particular, elected leaders."

If Congress believes current environmental laws don't adequately address global warming risks, changes should be enacted through the legislative process by those accountable to voters—not by financial regulators who have neither expertise nor accountability.

This principle extends to other issues as well. I'm troubled that regional Fed banks are focusing on politically charged issues, like racial justice activism, that are outside the Fed's mission and expertise. This week I sent letters to three regional Federal Reserve Banks about this behavior and requested information from them.

Instead of seeking to tackle issues that are outside the Fed's mandate and authorities, the Fed should focus on supervising the risks within its domain. For example, the Fed's recent Financial Stability Report highlights several risks that should be monitored—such as high asset prices. However, the report fails to consider a primary cause of these risks: the Fed's own excessively accommodative monetary policy.

Our economy experienced a significant shock last year, but it was met with unprecedented monetary and fiscal support. And the economy is now in full recovery mode. As a result, I don't understand the justification for the Fed maintaining its policy of near-zero interest rates and $1.4 trillion in bond purchases per year, amounting to roughly half of new Treasury debt issuance since the beginning of the pandemic. Let's not kid ourselves: we are effectively monetizing about $1 trillion of Federal debt per year.

This is especially troubling because the warning signs of inflation are getting louder. We may be seeing asset bubbles forming already, and history is replete with examples where the bursting of bubbles led to financial instability. As President Clinton's Treasury Secretary Larry Summers noted yesterday, the Fed needs to start "explicitly recognizing that overheating, and not excessive slack, is the predominant near-term risk for the economy."

I'm concerned that the Fed's current approach almost guarantees that it will be behind the curve if inflation becomes problematic and persistent—for two reasons. First, the Fed has announced it will allow inflation to run above its 2 percent target level. Second, the Fed insists that the inflation we're experiencing now is transitory. But you can only know something is transitory when it comes to an end. What if it does not come to end?

Another side effect of the Fed's asset purchases is the regulatory implications of such an abundance of reserves in the banking system. When the Fed purchases Treasuries or agency securities, the aggregate level of reserves rises correspondingly. As a result, reserves in the banking system have risen by over $2 trillion dollars and bank leverage ratios have experienced pressure from absorbing these riskless reserves that the Fed is creating.

Last year, the Fed recognized this problem and issued temporary relief that allowed banks to accommodate a surge of reserves. That relief has expired and there are signs that it was needed. The Fed recently stated that it will address this problem on a permanent basis. I urge you to do so swiftly.

Let me conclude with this: the Fed doesn't need to exceed its mandate and authorities to find risks to address. The siren calls of politically charged endeavors should be ignored, in order to preserve the credibility and independence of the Fed. There are plenty of risks within its reach, including those to which it may be contributing.

PREPARED STATEMENT OF RANDAL K. QUARLES

VICE CHAIRMAN FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MAY 25, 2021

Chairman Brown, Ranking Member Toomey, 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 1 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 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

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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, DC, 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.

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 4 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 6 months, we have 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

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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, DC (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.*

[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 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 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 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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[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, Washington, DC (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, DC (via webcast), October 15, 2020), *https://www.federalreserve.gov/newsevents/speech/quarles20201015a.htm.*

[12] See n. 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, "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*;

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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 postcrisis 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, 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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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.*

[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, DC, 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.*

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN BROWN FROM RANDAL K. QUARLES

Q.1. We see more and more severe weather events in Ohio and in all of my colleagues' States—from flooding to ice storms to catastrophic hurricanes. Taking these risks into consideration is something individual banks have done for a long time. How is the Fed supervising banks for climate risk on a system-wide basis? When can we expect the Fed to include climate risks in the big bank stress tests? The Fed should not wait several years to incorporate these risks—which could destroy trillions of dollars in assets—when the climate crisis is already here.

A.1. We expect supervised firms to manage effectively and mitigate all material risks they face, including those risks posed by climate change. With respect to climate-related risks, we are undertaking a broad work plan of analysis and public engagement. We are actively engaging with large financial institutions to strengthen our understanding of how they currently assess climate risks and incorporate the physical and transition risks from climate change into their risk management frameworks. We are also engaging with a wide range of stakeholders to ensure a broad range of diverse perspectives.

This engagement and our ongoing analytical work will inform our assessment of our supervisory program. As with all supervisory undertakings, we will tailor our approach and resources to focus on firms that face the most risk.

Climate scenario analysis is one of many tools that can be used to better understand the range of potential climate-related risks to the financial sector. Climate scenario analysis, which is distinct from regulatory stress tests, is a tool to explore how climate risks could evolve under a range of plausible scenarios. In contrast, 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. We are building our understanding of climate scenario analysis by engaging with financial institutions, academics, and foreign central banks, and other institutions to better understand scenario design.

We are taking a careful, thoughtful, and transparent approach to our work regarding climate related risks, and we will engage with Congress and the public along the way.

Q.2. During your testimony, you indicated that the Federal Reserve carefully reviews branch closures as part of its merger analysis. How many branches of banks involved in a merger or consolidation since June 1, 2011, have closed? How many of such closures have occurred in rural, minority, or low-moderate income areas? Please describe all instances in which the Federal Reserve bas denied a bank merger application because of concerns related to branch closures.

A.2. This response provides the requested data on the number of branch closures associated with banks that were involved in a merger or consolidation since June 1, 2011. The response also discusses certain limitations in the available data that do not enable an inference of causation to be established between branch closures since 2011 and M&A activity.

From 2011 to 2020, there was a net loss of 5,605 branches for banks that were involved in an M&A transaction over that period.[1] During this time period, the total net loss of branches that were located in counties that possessed one or more of the characteristics of being low-and moderate-income (LMI),[2] majority-minority,[3] or nonmetropolitan[4] was 2,453.[5]

The limitations of the data do not enable an inference of causation to be established between all of the net branch closures and M&A activity, because closures captured in these figures may have occurred for reasons unrelated to M&A activity. For example, the figures provided above include all of the branch openings and closings of the banks and savings associations involved in an M&A transaction (including at the holding company level) that occurred after the date of the institution's first instance of M&A activity in the period between 2011 to 2020. As an important caveat, the figures do not account for proximity in time between branch activity to the first associated M&A activity. Consequently, it would be difficult to associate some of an institution's branch closures with its M&A activity if those closures occurred well after the M&A transaction.

In addition, the data do not account for the geographic relationship between the branch activity and the M&A activity. The branch networks of an acquirer and target institution may only partially overlap or not overlap at all. It would be difficult to causally associate some of an institution's branch closures with the institution's M&A activity if such closures occurred outside the geographic area where the acquirer's and target's branch networks overlapped.

Moreover, branch consolidations resulting from M&A activity are reflected in the data as branch closures. In M&A transactions, the acquiring and target institutions may have branches that are located a short distance from one another in areas where the institutions have overlapping operations. Although the combined organization may consolidate nearby branches into a single branch to enhance operating efficiency, consolidation of this type generally would not limit customers' access to the bank's branches.

From 2011 to 2020, there was a net loss of 12,098 branches among all banks and savings associations nationwide. Although bank consolidation may be a factor in the overall decline, other factors have also contributed to this trend. These factors may include, for example, the rise in online and mobile banking products and services, increased competition from internet banks and nonbank fintech companies, changing customer preferences, increased branch operational costs, and, most recently, the COVID event.

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[1] "Branch" means full-service, brick and mortar retail bank branches.

[2] LMI counties are defined as counties with median family income less than 80 percent of national median family income for that year.

[3] Majority–minority counties are defined as counties in which less than half of the population is non-Hispanic White.

[4] Nonmetropolitan counties are defined as any county that is not part of a Metropolitan Statistical Area (MSA). An MSA is defined as an area with at least one urbanized area that has a population of at least 50,000 and comprises the central county or counties containing the core, plus adjacent outlying counties having a high degree of social or economic integration with the central county as measured by commuting data.

[5] These branches often possess multiple characteristics, and the total number of closed branches in LMI counties was 1,254 out of 2,453 total branches; the total number of closed branches in majority–minority counties was 1,062 out of 2,453 total branches; and the total number of closed branches in nonmetropolitan counties was 1,144 out of 2,453 total branches.

Between 2011 and present, the Board has not denied any M&A proposals due to concerns related to branch closures. The Board denies few M&A proposals overall because it has set clear standards about what M&A transactions it will approve. As a consequence of that transparency, bank holding companies and banks generally do not propose M&A transactions that would not meet the Board's standards.[6] In addition, some applicants choose to withdraw proposals prior to the Board's consideration. Approximately 12 percent of the merger applications submitted to the Federal Reserve from 2006 through 2020 were withdrawn.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM RANDAL K. QUARLES

Q.1. In your testimony before the Banking Committee you argued that Federal regulators should analyze potential climate-related risks and develop a "data-driven analytical framework" to guide your engagement with banks. You further noted that the Federal Reserve is in the "early stages" of doing that. Following your testimony, Acting Comptroller of the Currency Michael Hsu made comments on June 2, 2021, that appear to prejudge the outcome of this analysis.[1] He argued that regulators will "eventually" be required to incorporate climate-related risks into bank capital rules because "exposure is exposure and you have to risk manage and capitalize for that."[2] Do you believe that changes to the bank capital framework are an appropriate way to address climate-related risks?

A.1. Congress has given the Federal Reserve narrow but important mandates around monetary policy, financial stability, and supervision of financial firms, and we would consider the potential effects of climate change only to the extent they would affect the achievement of our statutory mandates. With respect to climate-related risks, we are undertaking a broad work plan of analysis and public engagement. We are actively engaging with large financial institutions to strengthen our understanding of how they currently assess climate risks and incorporate the physical and transition risks from climate change into their risk management frameworks. We are also engaging with a wide range of stakeholders to ensure a broad range of diverse perspectives.

Given that we are in the early stages of this work, we do not yet have a considered view about what actions might be appropriate from the Federal Reserve to address potential financial and economic risks of climate change once we have a more analytical understanding of that possibility. I would note that the Bank of England (BoE), which is considered among the most active global regulators in applying climate risk analysis to bank supervision, is running an analysis of its bank and insurance system's climate exposures that it is calling a stress test and which will be complete in

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[6] The Board has released publicly its approach to applications that may not satisfy statutory requirements for approval or that otherwise raise supervisory or regulatory concerns. This is reflected in the Board's Supervision and Regulation (SR) letter 14-2;Consumer Affairs (CA) letter 14-1: "Enhancing Transparency in the Federal Reserve's Applications Process", *https://www.federalreserve.gov/supervisionreg/srletters/sr1402.htm.*

[1] Pete Schroeder, Climate change risks will affect U.S. bank capital in long-run—official, Reuters (Jun. 2, 2021), *https://www.reuters.com/article/usa-regulator-banks/climate-change-risks-will-affect-us-bank-capital-in-long-run-official-idUSL2N2NJ2Y7.*

[2] Id.

the spring of 2022, yet even the BoE has been quite clear that this test will not be used to set capital standards. We are taking a careful, thoughtful, and transparent approach to this work, and we will engage with Congress and the public along the way.

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

Q.1. *Suspicious Activity Reports*—Last year, a *New York Times* article stated that major banks had filed Suspicious Activity Reports (SARs) that showed major financial institutions had helped suspected terrorists, drug dealers, and corrupt foreign officials move trillions of dollars around the world. [1]

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

A.1. We are committed to a strong anti-money laundering (AML) regime. The Federal Reserve expects banks operating in the United States to have an effective AML program as required by the Bank Secrecy Act (BSA) and appropriate measures in place to identify and report suspicious activity to law enforcement.

The Federal Reserve has taken action, and will continue to take action, to address BSA/AML deficiencies within its supervised institutions where warranted. Within the last several years, we have imposed enforcement actions against firms for failing to understand and mitigate the money laundering and terrorist financing risks associated with certain global business lines, activities, and customers.

While U.S. banks are neither required nor in an appropriate position to determine whether a crime has been committed, they are required to identify and report suspicious activity to FinCEN consistent with the relevant suspicious activity reporting regulations.

Banks are required to file SARs in a wide range of circumstances. U.S. banks are obligated to screen all transactions for suspicious activity, even those for which the bank does not have a direct customer relationship with the originator of the transaction, such as in the case of foreign correspondent banking.

Q.2. What steps is the Federal Reserve instituting to ensure that financial institutions comply with the Anti-Money Laundering Act of 2020?

A.2. We are committed to ensuring that our supervised entities comply with BSA/AML laws and regulations. The Federal Reserve is working closely with the U.S. Department of the Treasury, FinCEN, and the other Federal and State banking supervisors to provide meaningful consultation and support for effective, appropriately tailored implementation of the AML Act reforms. In addition, the Federal Reserve and other Federal and State banking supervisors are collaborating through the Federal Financial Institutions Examination Council's BSA/AML Working Group to update

[1] *https://www.nytimes.com/2020/09/20/business/fincen-banks-suspicious-activity-reports-buzzfeed.html*

our supervisory approach, as necessary, to incorporate AML Act reforms.

Q.3. *Archegos Capital Management*—In the May 2020 Financial Stability Report,[2] the Federal Reserve warned about the high level of "business-sector debt." Since then the implosion of the Archegos Capital Management resulted in a $10 billion loss to Credit Suisse and Morgan Stanley.

How will the Federal Reserve adjust its stress tests for large financial institutions to ensure that banks can accurately project major trading losses for their private fund clients?

Will the Federal Reserve include hypothetical scenarios based on overleveraged private fund clients in its annual bank stress tests?

A.3. The Federal Reserve's supervisory stress test incorporates global market shock and counterparty default components to assess the risks of firms with significant trading activities. In the June 2020 and December 2020 supervisory stress tests, the Federal Reserve projected trading and counterparty losses of $83.2 billion and $95.1 billion, respectively, under the severely adverse scenario for the 13 firms with significant trading activities. These amounts are far larger than the total global losses stemming from Archegos, the great bulk of which were incurred by foreign banks outside the United States and nearly 100 times larger than the minor portion of Archegos losses that fell within the Federal Reserve's regulator perimeter.

Consistent with the Federal Reserve Board's Policy Statement on the Scenario Design Framework for Stress Testing (Scenario Design Framework), we consider emerging and ongoing areas of financial market vulnerability in the development of the global market shock component. For example, over the last few years the global market shock component has emphasized heightened stress to highly leveraged markets. We will continue to develop our supervisory stress test scenarios according to the Scenario Design Framework, ensuring that salient risks are captured.

As part of our capital plan assessment, we review the assumptions and methodologies used by firms to project revenues and losses under a range of stressful conditions, including an internal stress scenario that is reflective of a firm's unique risk exposures and business activities. This assessment helps to highlight key weaknesses in a firm's internal processes that can result in additional supervisory scrutiny.

Q.4. *Cyber Risks*—Federal Reserve Bank of Cleveland President Loretta Mester urged further development and use of stress testing to assess the financial system's resilience to cyber risks.

How can an institution ensure that the data it backed up has not already been altered?

A.4. In today's data driven marketplace, data integrity is extremely important for any financial institution's operations and decision making. We recently published interagency guidance that outlines sound practices for strengthening operational resilience. The guidance contains a number of practices that seek to ensure the effec-

[2] *https://www.federalreserve.gov/publications/files/financial-stability-report-20200515.pdf.* P. 33.

tiveness of processes and controls to protect the confidentiality, integrity, availability, and overall security of the firm's data and information systems. One such practice is for firms to establish controls to safeguard the integrity and availability of critical data against the impact of destructive malware, including ransomware, or other similar threats. Recovery from such incidents may include use of protocols for secure, immutable, off-line storage of critical data. In addition, we point institutions to National Institute of Standards and Technology (NIST) resources such as: *NIST Special Publication 1800-11-Data Integrity Recovering from Ransomware and Other Destructive Events*[1] and the *NIST draft white paper, Securing Data Integrity Against Ransomware Attacks: Using the NIST Cybersecurity Framework and NIST Cybersecurity Practice Guides*[2] for more detailed information.

Q.5. We see more cybercriminals target small businesses, leading to a loss of revenue, jobs and in some cases, putting some out of business.

How should financial institutions consider the impact of cybercrime when they lend to small businesses?

A.5. There are several potential risks that may limit or render a small business incapable of fulfilling the terms of its loan agreement with its lender, including cybercrime. As part of their underwriting, lenders should consider how the small business's ability to repay could be affected for a variety of risks including cyberincidents. The level of cyberpreparedness and hygiene of a small business could be considered as factors in underwriting together with other risks that could affect the borrower's ability to repay.

As banks themselves become more aware of cyber risks, they could provide a useful channel for increasing awareness among their customers, especially small businesses, to heightened resilience and the need to have appropriate safeguards to manage these risks.

Q.6. *Expanding on Your Testimony*—In your testimony, you call for "further review of changing patterns in the use of financial services, by consumers and businesses; and a changing relationship between banks and their nonbank partners."

Besides greater online banking, what changing patterns has the Federal Reserve noticed in the usage patterns of customers of financial services companies?

A.6. Customers' use of digital financial services—banking, payments, investment, insurance, lending, and financial planning—increased substantially in the years preceding the COVID event and continued to accelerate during the last year. Customers are starting to use online channels for a range of financial activities that span beyond checking account balances, including financial transactions such as making payments, seeking loans, or investing money. For example, according to the 2020 edition of McKinsey's

[1] See NIST Cybersecurity Practice Guide SP 1800-11, "Data Integrity: Recovering from Ransomware and Other Destructive Events".

[2] See the NIST draft white paper, "Securing Data Integrity Against Ransomware Attacks: Using the NIST Cybersecurity Framework and NIST Cybersecurity Practice Guides".

annual Digital Payments Consumer Survey,[3] more than three-quarters of Americans use some form of digital payment, such as browser-based and in-app online purchases, in-store checkout using a mobile phone and/or Quick Response code, and person-to-person payments. In some cases, consumers are gaining access to these services through their banks; in other cases, through nonbank fintech companies.

In addition, consumers are increasingly getting customer service through digital channels. A number of banks have leveraged new technologies such as artificial intelligence (AI) to enable 24x7 chatbots, which can answer basic customer service questions.

Consumer surveys such as the 2019 E&Y Global FinTech Adoption Survey[4] and the 2019 PwC Global Fintech Report[5] show shifting customer preferences with respect to the use of online financial services. Price, ease of setup, user experience, and access to innovative products are all important factors for consumers using new fintech services.

Businesses are also seeking to leverage advances in financial technology for services such as lending, payments technology, fraud detection, and data processing services. For example, the 2020 Federal Reserve Small Business Credit Survey[6] found that 20 percent of small businesses had used an online (nonbank) lender for funding in the past 5 years. Medium/high-credit-risk applicants were more inclined to apply to online lenders and were more than twice as likely as other applicants to state that denials by other lenders drove their application decisions. They also had the greatest chance of success at online lenders, with 77 percent getting approved in comparison to a 40 percent approval rate at a large bank.

Q.7. What concerns do you have about the commercial real estate market? If remote work increases substantially, do you expect to see any risk to the financial system due to outstanding commercial real estate loans?

A.7. As noted in the May 2021 Financial Stability Report (FSR), disruptions caused by the COVID event continue to make it difficult to assess valuations in the commercial real estate (CRE) sector. Since late 2020, CRE price indexes based on transactions recovered from their decline early last year, suggesting elevated pressures. Further, capitalization rates, which measure annual income relative to prices of commercial properties, have continued to tick down. Yet, other measures suggest market participants perceive values as having fallen over the past year.

For example, an index of the prices of CRE properties administered by real estate investment trusts (REITs), which supplements observed transactions with appraisal information, remains below pre-COVID levels.[7] Similarly, stock prices of REITs that invest in harder-hit commercial property sectors have increased since November but generally remain below their pre-COVID levels.

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[3] See 2020 McKinsey Digital Payments Consumer Survey.
[4] See 2019 E&Y Global FinTech Adoption Survey.
[5] See 2019 PwC Global Fintech Report.
[6] See 2020 Federal Reserve Small Business Credit Survey.
[7] The Green Street price index remained below its pre-COVID level in February. This index is appraisal based, using both sales and nonsales information to track prices of properties managed by REITs.

Other indicators continue to show strains in CRE markets. Vacancy rates continue to increase and rent growth has declined further. Additionally, delinquency rates on commercial mortgage-backed securities (CMBS), which usually contain riskier loans, remain elevated. Delinquency rates for CRE loans secured by COVID-affected properties, such as hotels and retail properties, also rose during the second half of 2020. Finally, the January 2021 Senior Loan Officer Opinion Survey on Bank Lending Practices[8] indicated that banks, on net, reported weaker demand for most CRE loans and tighter lending standards in the fourth quarter of 2020.

It is too early to determine the long-term trends arising from a prolonged work from home environment such as has been experienced during the COVID event. The Federal Reserve will continue to monitor the CRE market as these trends materialize.

Q.8. Your testimony notes that these changes have "important implications for financial stability, safety and soundness, consumer protection, and underserved communities' access to safe and fair financial services."

What are the implications for consumer protection and underserved communities' access to safe and fair financial services you wish to bring to the attention of Congress, the banking sector, the markets and the public?

A.8. As noted in my response to Question 4, customers' use of digital financial services—banking, payments, investment, insurance, lending, and financial planning—increased substantially in the years preceding the COVID event and continued to accelerate during the COVID event. The Federal Reserve strongly supports responsible innovation and recognizes the benefits it can offer to financial institutions, businesses, and consumers, as seen by the vital role innovative technology played in enabling the economy and financial services throughout the course of the last year.

We also realize that innovation can lead to new and unforeseen risks. In the financial arena, we have seen through the years that many innovations, while beneficial, brought new ways to introduce familiar problems, such as leverage, maturity transformation, inadequate risk management, and too-big-to-fail issues to manifest.

The combination of rapid changes in technology, the rise of large technology firms, and the fact that oversight of these entities and their financial activities may be limited and dispersed across many different regulatory bodies provide a real challenge—particularly to the financial system—as society attempts to promote responsible innovation.

The Federal Reserve is focused on ensuring its oversight takes into account technological innovation, particularly for our supervised institutions. Much fintech development is happening in the nonbank sector and the Federal Reserve does not have direct supervisory authority over nonbank fintechs. However, we continue to monitor developments to assess their potential impact on the banking sector and on financial stability. We also regularly discuss these topics with the other agencies. In March 2021, along with the other Federal financial regulatory agencies, we jointly issued an

[8] *https://www.federalreserve.gov/data/sloos/sloos-202101.htm*

interagency request for information on risk management of AI in financial services.[9] As nonbank fintechs partner with banking organizations we supervise, we carefully review those partnerships to ensure they do not raise risks to banks' safety and soundness and comply with consumer protection requirements, including fair lending laws and regulations that prohibit illegal discrimination.

The Federal Reserve's robust fair lending supervisory and enforcement program reflects our commitment to promoting fair lending and identifying unlawful discrimination in the institutions we supervise. We examine for fair lending risk at every consumer compliance exam, and a bank's fintech activities are assessed within the fair lending review, commensurate with the level of risk. In studying the benefits and challenges of fintech, we look at the potential risks of amplifying bias and inequitable outcomes. It is important that we understand how complex data interactions may skew the outcomes of algorithms in ways that undermine fairness and transparency.

Q.9. In your testimony, you note the use of artificial intelligence (AI) specifically.

What concerns does the Federal Reserve have regarding AI?

A.9. The Federal Reserve supports responsible innovation by financial institutions. With appropriate governance, risk management, and compliance management, financial institutions' use of AI has the potential to offer improved efficiency, enhanced performance, and cost reduction for financial institutions, as well as benefits to consumers and businesses.

At the same time, the use of AI presents a variety of risks. Many of the potential risks associated with using AI are not unique to AI. For instance, the use of AI could result in operational vulnerabilities, such as internal process or control breakdowns, cyberthreats, information technology lapses, risks associated with the use of third parties, and model risk, all of which could affect a financial institution's safety and soundness. However, AI may present particular risk management challenges to financial institutions, such as those in the areas of explainability, data usage, and dynamic updating. The use of AI can also create or heighten consumer protection risks, such as risks of unlawful discrimination, unfair, deceptive, or abusive acts or practices under the Dodd–Frank Wall Street Reform and Consumer Protection Act, unfair or deceptive acts or practices under the Federal Trade Commission Act, or privacy concerns.

The Federal Reserve, in coordination with our fellow Federal banking agencies, has taken a variety of steps to assess the benefits and risks associated with AI. These steps have included outreach to a wide range of external parties, including banks, consumer groups, vendors, and others to hear a range of perspectives on how the technology is being used and particular risk management challenges that banks face in using the technology. Among other efforts, the agencies hosted an Ask the Regulators session for

[9] See Federal Reserve Board, Press Releases, "Agencies Seek Wide Range of Views on Financial Institutions' Use of Artificial Intelligence", March 29, 2021, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210329a.htm.*

bankers in December 2020, and the Federal Reserve hosted a 2-day academic symposium on AI in January 2021.

Further, in March 2021, in collaboration with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Consumer Financial Protection Bureau, and National Credit Union Administration, the Federal Reserve published a Request for Information (RFI) to explore whether additional supervisory clarity is needed to facilitate the responsible use of AI. The RFI explores the benefits and risks noted above in more detail. The agencies are seeking feedback from a wide range of stakeholders, including financial services firms, technology companies, consumer advocates, civil rights groups, merchants, and other businesses, and the public to inform any future policy steps in this area. The agencies intend to continue working together on further activities related to AI.

Q.10. How will the Federal Reserve ensure that AI does not lead to discrimination in financial services?

A.10. Discrimination has no place in a fair and transparent marketplace. Discriminatory practices can close off opportunities and limit consumers' ability to improve their economic circumstances, including through access to home ownership and education. The Fair Housing Act (FHA) and Equal Credit Opportunity Act (ECOA) were enacted to help ensure consumers are treated fairly when offered financial products and services. The Federal Reserve supervises the institutions it oversees for compliance with these laws to ensure that banks do not discriminate on the basis of race, color, national origin, sex, religion, marital status, familial status, age, handicap/disability, receipt of public assistance, and the good faith exercise of rights under the Consumer Credit Protection Act (collectively, the "prohibited bases").

The Federal Reserve's fair lending supervisory program reflects our commitment to promoting financial inclusion and ensuring that the financial institutions under our jurisdiction fully comply with applicable Federal consumer protection laws and regulations. In studying the benefits and challenges of fintech, including AI, we look at the potential risks of introducing or amplifying bias. It is important that we understand how complex data interactions may skew the outcomes of algorithms in ways that undermine fairness and transparency. We review the use of fintech, including AI, in consumer lending as part of our supervisory program, including evaluating whether banks' use of AI creates consumer protection risks.

In addition to our supervisory work, we proactively support financial institutions in their efforts to guard against fair lending risks through outreach efforts that promote sound compliance management practices and programs, including with respect to the use of AI. Outreach efforts include Consumer Compliance Outlook, a widely subscribed Federal Reserve System publication focused on consumer compliance issues which has included several focus pieces on the use of technology in banking, its companion webinar series, Outlook Live, as well as the Consumer Compliance Supervision Bulletin, which had an issue dedicated to fintech. We continue to engage with public stakeholders and to study the benefits and challenges of fintech, including potential risks of amplifying

bias and inequitable outcomes. We hosted a public symposium dedicated to leading academics discussing AI and bias and held an interagency “Ask the Regulator” webinar on banks’ use of AI in December 2020.

The March 2021 interagency RFI on AI includes a section dedicated to fair lending, seeking input on techniques available to facilitate or evaluate the compliance of AI-based credit determination approaches with fair lending laws; the risks that AI can be biased and/or result in discrimination on prohibited bases and how to reduce any such risks; how existing principles and practices aid or inhibit evaluations of AI-based credit determination approaches for compliance with fair lending laws; and challenges financial institutions may face when applying internal model risk management principles and practices to the development, validation, or use of fair lending risk assessment models based on AI.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SCOTT FROM RANDAL K. QUARLES

Q.1. I want to address your work with the International Association of Insurance Supervisors and the current monitoring period of the Insurance Capital Standard.

While these terms might not mean much to the average South Carolinian, a bad outcome will mean that the average South Carolinian will have their access to retirement products and insurance services severely restricted. Recognition of O.S. insurance capital standards as outcome-comparable to the ICS is the ultimate and measurable goal here.

In speaking on this topic to the National Association of Insurance Commissioners, you stated that if differences between international insurance markets were significant, “a one-size-fits-all methodology could produce unintended consequences, send false signals to regulators or capital markets, and ultimately be destabilizing.” Europeans do not have a need for private-sector retirement products. Or private health insurance. Our markets are radically different. A one-size-fits-all approach to capital regulation will be a disaster.

Vice Chair Quarles, you are one of the most powerful international regulatory voices in the world. You have extensive relationships with the key financial regulatory personnel—around the globe. I strongly urge you to commit to using all necessary political capital to have the O.S. system of insurance regulation formally deemed as equivalent at the IAIS before your tenure at the Federal Reserve comes to a close.

Is the Federal Reserve prepared to vote in favor of the time-tested O.S. system of insurance regulation and deem group capital measurement standards as preferable and outcome comparable to the ICS? Perhaps better said, are you going to stand up for both my constituent policyholders and American insurers?

A.1. Yes, the Federal Reserve is committed to standing up for U.S policy holders and insurers.

While it is important to note that none of the standards set by the International Association of Insurance Supervisors (IAIS) have binding effect on the United States, we believe that it is in our national interest to engage in the international insurance standards-

development process so that it produces standards that protect the U.S. market and U.S. consumers when foreign insurers operate here through their U.S. subsidiaries and that are appropriate for U.S. companies operating abroad in a similar fashion.

The Federal Reserve advocates for the U.S. approach to insurance regulation at the IAIS. To assess the adequacy of group capital, U.S. regulators have proposed aggregating existing legal entity capital requirements, referred to as the Aggregation Method (AM). The Federal Reserve Board (Board) proposed a similar approach, termed the Building Block Approach (BBA), for depository institution holding companies significantly engaged in insurance activities. The National Association of Insurance Commissioners and the States have proposed a similar approach, the Group Capital Calculation (GCC). The Federal Reserve will continue to advocate for the AM to be deemed an outcome-equivalent approach for implementation of the Insurance Capital Standard.

Q.2. I am very interested in the promulgation of the final rule applying capital standards to insurance companies that own banks. I am concerned that the proposed rule would impose a separate "Collins Amendment" calculation on certain insurance companies, based solely on their business structure. I do not believe this separate calculation to be statutorily required and it runs directly counter to the sole reason Congress enacted a—law in 2014—to prevent banking capital standards from being imposed on insurance companies. Will you commit to resolving this issue to better reflect the will of Congress in the final rule?

A.2. As part of the Board's notice ofproposed rulemaking regarding capital requirements for depository institution holding companies that are significantly engaged in insurance activities (proposal), the Board proposed to establish a section 171 calculation to comply with section 171 of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Act), which, in part, requires the Board to establish minimum risk-based capital requirements for depository institution holding companies on a consolidated basis. The proposed section 171 calculation would satisfy the requirement in section 171 of the Dodd–Frank Act to establish a minimum risk-based capital requirement on a consolidated basis for depository institution holding companies, while excluding from this calculation State-regulated insurers to the full extent permitted by the Insurance Capital Standards Clarification Act of 2014 (the Clarification Act).

The Board invited public comment on all aspects of the proposal, including the section 171 calculation. Several comments suggested that the Building Block Approach (BBA) would comply with the statutory requirements without an additional calculation because the BBA's minimum requirement would not be less than the generally applicable capital requirement.

Consistent with the Administrative Procedure Act, the Board will consider the comments on the proposal, the requirements of section 171 of the Dodd–Frank Act (as amended by the Clarification Act), and other provisions of law, before making a final rule. The Board continues to consider whether the proposed section 171 calculation is necessary in order to ensure that minimum risk-based capital re-

quirements for depository institution holding companies that are significantly engaged in insurance activities are established on a consolidated basis.

Q.3. In recent weeks, you stated: “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,” and “[t[he 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.”

How do you reconcile these statements with the fact that the Federal Reserve is planning to propose Basel III finalization rules this year that will potentially drive a large increase in bank capital requirements?

A.3. As I have often stated, the levels of loss absorbing capital in the banking system that have largely prevailed throughout my term at the Federal Reserve, are generally appropriate. Strengthened by a decade of improvements in capital, liquidity, and risk management, banks have continued to be a source of strength during the past year. As we work to implement the Basel III reforms in the United States, we will aim to maintain these levels of overall strength in our bank capital requirements.

Q.4. As the Federal Reserve 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?

A.4. 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.

Q.5. And finally, how does the Federal Reserve intend to release the economic impact analysis to ensure transparency of impact across all categories of institutions?

A.5. 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*.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR ROUNDS FROM RANDAL K. QUARLES

Q.1. As a follow-up to your exchange with Senator Warren on the Large Institution Supervision Coordinating Committee (LISCC), would any changes made to LISCC designations over your term have prevented what happened at Archegos?

A.1. The Archegos-related exposures that ultimately led to substantial losses in the non-U.S. operations of certain non-U.S. banks were largely established while the U.S. operations of those banks were supervised as part of the LISCC portfolio at the Federal Reserve, so the change of supervisory portfolio was not a factor in the practices that led to the losses. Nor was the Archegos incident an example of a failure of Federal Reserve supervision, whether LISCC or non-LISCC: the great bulk of the losses associated with Archegos occurred in non-U.S. banks, in activities outside the U.S. bank regulatory perimeter that are supervised by authorities other than the Federal Reserve. Only a small portion of the Archegos-related losses fell within the Federal Reserve's jurisdiction, and in our annual stress tests of the U.S. banking system we regularly ensure the ability of the U.S. system to withstand capital market activity losses that are as much as 100 times as large as the Archegos losses in the United States, and indeed nearly 9 times as large as the aggregate Archegos losses in the entire global banking system.

Finally, the realignment of certain banks from the LISCC supervisory portfolio to our Large and Foreign Banking Organization (LFBO) portfolio will not make future such incidents any more likely. LFBO supervision is not "weaker" supervision; it is supervision of firms in a manner that allows the comparison of firms with similar risks to each other. The realigned banks have reduced the size of their U.S. operations dramatically, so the U.S. risks of those operations are now more similar to those of similarly sized foreign banks that have already long been supervised in our LFBO portfolio than they are to the U.S. global systemically important banks (GSIBs) that now constitute our LISCC portfolio.

More specifically, the Federal Reserve Board (Board) sorts firms into supervisory portfolios based on considerations outlined in the Board's tailoring rule and consistent with the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018. Specifically, the Board applies regulatory standards to firms on the basis of size, cross-jurisdictional activity, nonbank assets, weighted short-term wholesale funding, and off-balance-sheet assets.

The Federal Reserve supervises the intermediate holding companies of foreign banking organizations under the Large Foreign Banking Organization portfolio with other large and complex firms that are not U.S. GSIBs and subjects them to standards of supervision and regulation commensurate with their risk. The goal of these stringent standards across supervisory portfolios is to require

these firms to hold sufficient capital and liquidity. No matter the supervisory portfolio, supervisory focus is directed to drivers of risk for individual firms to ensure that effective systems are in place such that risks like those resulting from the Archegos default are identified in a timely manner and appropriately analyzed and mitigated such that associated losses are nonsystemic if they do occur.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TILLIS FROM RANDAL K. QUARLES

Q.1. In recent testimony before the House Financial Services Committee, who stated that the Fed's supervisory stance was not materially deficient and that a "bulk" of the losses related to Archegos occurred outside the United States, and thus, did not present a material risk to the U.S. economy. You also said any regulatory proposals in response would be premature and this "remains largely a risk management issue." Given your remarks and the fact that both LISCC and non-LISCC firms, which are subject to the same heightened capital and liquidity requirements, had exposure to Archegos, is it a leap to suggest that placing all of the recently removed firms back into LISCC would have prevented the losses from occurring?

A.1. The Archegos-related exposures that ultimately led to substantial losses in the non-U.S. operations of certain non-U.S. banks were largely established while the U.S. operations of those banks were supervised as part of the LISCC portfolio at the Federal Reserve, so the change of supervisory portfolio was not a factor in the practices that led to the losses. Nor was the Archegos incident an example of a failure of Federal Reserve supervision, whether LISCC or non-LISCC: the great bulk of the losses associated with Archegos occurred in non-U.S. banks, in activities outside the U.S. bank regulatory perimeter that are supervised by authorities other than the Federal Reserve. Only a small portion of the Archegos-related losses fell within the Federal Reserve's jurisdiction, and in our annual stress tests of the U.S. banking system we regularly ensure the ability of the U.S. system to withstand capital market activity losses that are as much as 100 times as large as the Archegos losses in the United States, and indeed nearly 9 times as large as the aggregate Archegos losses in the entire global banking system.

Finally, the realignment of certain banks from the LISCC supervisory portfolio to our Large and Foreign Banking Organization (LFBO) portfolio will not make future such incidents any more likely. LFBO supervision is not "weaker" supervision; it is supervision of firms in a manner that allows the comparison of firms with similar risks to each other. The realigned banks have reduced the size of their U.S. operations dramatically, so the U.S. risks of those operations are now more similar to those of similarly sized foreign banks that have already long been supervised in our LFBO portfolio than they are to the U.S. global systemically important banks (GSIBs) that now constitute our LISCC portfolio.

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Regulatory Relief and Consumer Protection Act of 2018. Specifically, the Board applies regulatory standards to firms on the basis of size, cross-jurisdictional activity, nonbank assets, weighted short-term wholesale funding, and off-balance-sheet assets. The Federal Reserve supervises the intermediate holding companies of foreign banking organizations under the Large Foreign Banking Organization portfolio with other large and complex firms that are not U.S. GSIBs and subjects them to standards of supervision and regulation commensurate with their risk. The goal of these stringent standards across supervisory portfolios is to require these firms to hold sufficient capital and liquidity. No matter the supervisory portfolio, supervisory focus is directed to drivers of risk for individual firms to ensure that effective systems are in place such that risks like those resulting from the Archegos default are identified in a timely manner and appropriately analyzed and mitigated such that associated losses are nonsystemic if they do occur.

Q.2. Thank you for your letter to update me last week on the Board staff efforts to analyze and consider different approaches to update Regulation T to make additional OTC securities margin eligible. I appreciate the desire that any amendments to Reg T would be "straightforward to implement" and "cover a meaningful set of OTC stocks that are liquid but not already margin-eligible." As you know, these rules have not been updated since 1999, when Nasdaq was the primary electronic market for OTC securities. Since then, there have been significant developments in the OTC marketplace, including Nasdaq becoming an exchange over 14 years ago, and the many improvements made since then to increase transparency, liquidity, and information in OTC securities. An update on the margin eligibility for OTC securities is long overdue. Can you give me a timeframe for when I can expect to see a proposal from the Fed on this issue?

A.2. Board staff are continuing to explore avenues for increasing the universe of equity securities eligible as collateral for securities trading at broker-dealers. Board staff are consulting with industry representatives and other regulators in an attempt to develop a meaningful standard for assessing the creditworthiness, as collateral, of stocks not traded on a U.S. securities exchange. These consultations involve a number of details and issues that are not in our control and I thus cannot yet give a definitive timetable for when this effort will be complete. We remain however actively engaged in the matter.