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OVERSIGHT OF FINANCIAL REGULATORS: A STRONG BANKING AND CREDIT UNION SYSTEM FOR MAIN STREET

HEARING

BEFORE THE

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

ONE HUNDRED SEVENTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING PRUDENTIAL REGULATION AND CONSUMER PROTECTION FOR BANKS, SAVINGS ASSOCIATIONS, AND CREDIT UNIONS, AND THE AGENCIES' ACTIONS TO ENSURE THAT FINANCIAL INSTITUTIONS SERVE THEIR CUSTOMERS AND COMMUNITIES

NOVEMBER 15, 2022

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C O N T E N T S

TUESDAY, NOVEMBER 15, 2022

WITNESSES

OVERSIGHT OF FINANCIAL REGULATORS: A STRONG BANKING AND CREDIT UNION SYSTEM FOR MAIN STREET

TUESDAY, NOVEMBER 15, 2022

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

The Committee met at 10 a.m., via Webex and in room 538, Dirksen Senate Office Building, 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. Welcome to the witnesses and Committee Members.

We know that most Americans want the same things: a safe, affordable place to call home, a good-paying job, and a strong, stable Government which they can trust. Our democratic institutions are only as strong as the people who empower them. Our economy works best when we have a free and fair democracy in which everyone can live their lives with dignity.

For too long, many of these dreams have felt out of reach. Working families struggle to pay for groceries, to keep gas in their car, and a roof over their heads. We know the cost of living and raising kids continues to rise.

Democrats are listening and have delivered for the American people. We passed legislation to lower prescription drug costs. We helped families stay in their homes during the height of the pandemic. We made investments in public transit and our Nation's infrastructure. For the first time in generations we have been focused on communities that our Government has turned their back on, especially, for instance in my State, the State government. Now we are tackling inflation by taking on corporate power and consolidation and by reducing our dependence on foreign oil.

We are doing all that while creating good-paying manufacturing jobs at home. These jobs, making semiconductors, electric vehicles, and solar panels, are the jobs of the future. Those jobs will go to Americans because we passed the CHIPS Act, the Inflation Reduction Act, and the Bipartisan Infrastructure Law, with strong Buy America provisions that Senator Portman and I worked on.

And we are seeing results. Our economic recovery has been strong. Over the past 2 years, many Americans have built up more in savings. We have seen robust job growth and, for the first time

in decades we have seen wage gains. Just last week we began to see signs that inflation is starting to cool. Banks and credit unions are doing well, thanks to the protections we put in place in Dodd-Frank and because of the support Congress and regulators provided during the pandemic.

Too many big corporations, though, have taken advantage of market concentration, jacking up consumer prices and earning higher and higher profits. As my colleague Senator Reed has pointed out, the biggest banks that benefit from higher interest rates today are not passing on those benefits to their customers, again penalizing Americans who are trying to buildup savings.

Workers and small businesses already struggling under the weight of inflation should not get hit with exorbitant bank fees, should not lose their money to a crypto scam, should not have to worry that their savings will disappear overnight if a mismanaged bank or credit union fails. None of us want a scenario where risky bets on Wall Street crash the economy again.

That is why it is so important that we have financial watchdogs like the four of you, who are empowered to look out for Main Street, helping more Americans hold on to their hard-earned money at a time when they need it most.

The banking and credit union regulators are independent agencies that protect consumers and make sure banks and credit unions are safe and strong. Your independence matters. It makes for a more stable financial system and that is essential for our entire economy.

Our witnesses today all have decades of banking and credit union regulatory experience. They have spent careers serving the public and protecting consumers, making sure our banking and credit union system works for Main Street, not just for Wall Street.

That is exactly what they continue to do today.

They are modernizing and strengthening an important civil rights law that will spur new investment in neighborhoods and communities that have been left on their own. Thank you for that.

They have taken a closer look at overdraft, nonsufficient funds, and other "gotcha" fees at banks and credit unions to make sure that consumers are treated fairly, and that these fee programs do not raise safety and soundness concerns. Thank you for that.

They are taking a fresh look at the bank merger approval process, so we do not continue this rubber stamp consolidation which has big consequences for local economies. Too often big banks merge and close branches, leaving rural towns and urban communities without a bank.

They are revisiting the financial safeguards that protect us from risks at big foreign banks, making sure bank failures do not leave taxpayers holding the bag. It is important to remember the super-regional banks of today are hundreds of billions of dollars larger than the largest banks that failed during the financial crisis. Our financial regulators know that we need strong capital requirements so that banks and credit unions can continue to lend to and invest in their communities, in good times and bad.

They are also overseeing the formation of new institutions that serve communities that often get left behind. Just last week, the NCUA chartered a new faith-based credit union, and the FDIC re-

cently approved the first mutual bank in 50 years, which will pave the way for more, in Ohio and across the country. All the agencies are working together to foster new banks and credit unions, and support the work of MDIs and CDFIs in their communities.

At the same time, our regulators are looking out for risks on the horizon—the effects of climate change, the rise in crypto assets, the risks from shadow banks, and the constant threat of cyberattacks. They are working with the banking and credit union industry to prepare for climate-related risks and bolster cybersecurity protections as criminals become more sophisticated and geopolitical threats increase. They have stepped up to protect depositors and consumers when crypto firms mislead them into thinking their money is safe, when it is not.

But we must stay vigilant and empower regulators with the tools to combat these growing risks. Data breaches at banks and credit unions happen too often, threatening customer data and exposing our financial system to vulnerability. That is why we need to pass the bipartisan Improving Cybersecurity of Credit Unions Act led by Senators Ossoff, Lummis, and Warner.

We need to make sure that banks and credit unions can partner with third parties in a way that allows banks to stay competitive without putting consumer money at risk. And we cannot let big tech companies and risky shadow banks play by different rules because of special loopholes.

All these things will help strengthen our banking and credit union system for its core mission: serving Main Street and workers and families. When workers have more power in the economy, they find better paying jobs and we have a stronger labor market. That helps credit unions, which added over 5 million new members over the past year, and drives down the number of households without a bank account, which dropped to record lows in 2021.

When Government is on the side of working families more Americans save money, more Americans build wealth, more Americans start small businesses, and more Americans participate in our economy.

Our financial regulators have answered that call—thank you for that—and I will continue to work with them to make sure our banking and credit union system works for everyone.

Before I conclude my remarks, I want to thank the witnesses again for being here today. I also want to especially congratulate Marty Gruenberg on being nominated by President Biden to be Chair of the FDIC. Marty is a well-respected and seasoned regulator who has worked to protect consumers and preserve confidence in our banking system. He played an instrumental role in helping implement many of the Dodd-Frank reforms. With his experienced leadership I have no doubt that FDIC can continue to address risks to our financial system, increase access to affordable financial services, and ensure that banks honor their commitment to communities through the CRA.

This Committee looks forward to holding a nomination hearing in the next few weeks for Marty and the other FDIC nominees.

Senator Toomey.

OPENING STATEMENT OF SENATOR PATRICK J. TOOMEY

Senator TOOMEY. Thank you, Mr. Chairman, and welcome to our witnesses.

Throughout this Congress, I have warned about the politicization of financial regulation. Some bank regulators are increasingly straying outside their mandates into politically contentious issues.

Take global warming, for instance. In September, the Fed announced a, quote, "pilot climate scenario analysis exercise," end quote, with six of the largest U.S. banks. Now we are told this is merely an exercise in ensuring that banks understand their risks. But the data, including the Fed's own research, shows that there is no physical risk to banks from severe weather events.

The only other risk is so-called "transition risk."

But we also know banks are fully capable of pricing risks into their business decisions, including risks from changing customer preferences over time.

So the real risk here is political.

My worry is that an attempt to somehow quantify this political risk will eventually result in regulations designed to allocate capital away from carbon-intensive companies.

It appears some bank regulators are already committed to doing just that. For example, the Fed, FDIC, and OCC have all joined the "Network for the Greening the Financial System." This is an international group of financial regulators with a stated aim to, and I quote, "mobilize mainstream finance to support the transition toward a sustainable economy," end quote.

In other words, their goal is to allocate capital away from carbon-emitting industries to those deemed to be sufficiently green.

And let me emphasize—the Fed, FDIC, and OCC have all joined this group.

The NCUA has also warned that credit unions, and I quote, "may need to consider adjustments to their fields of memberships as well as the types of loan products they offer," end quote, and that is because of global warming.

Here is the reality. Some unelected financial regulators want to accelerate the transition to a lower-carbon economy by misusing their powers to allocate capital away from traditional energy companies.

But addressing global warming requires really difficult political decisions. It involves tradeoffs. And in a democratic society, these tradeoffs have to be made by elected and accountable representatives, representatives of the American people who are held accountable through the political process.

Now I supported Vice Chairman Barr's nomination, despite a number of policy differences I have with him, based, in part, on his commitment to stick to the Fed's narrow mandates.

At his confirmation hearing, Vice Chairman Barr stressed that the Fed, and I quote, "should not be in the business of telling financial institutions to lend to a particular sector or not to lend to a particular sector," end quote. I thank him again for that clarity and I urge him to keep to that commitment, and one way we could do that is by pulling the Fed out of the politically contentious issue of global warming.

Federal banking regulators have also been preoccupied, in some cases, with establishing new rules, the need for which have been dubious. For example, last month the Fed and FDIC proposed potential new requirements concerning the resolvability of regional banks. This proposal seems to be predicated on the assumption that the only realistic option to resolve a large regional bank would be to sell it to an even larger bank.

But it is not at all clear that this assumption is warranted, or that new requirements are appropriate for regional banks, for at least two reasons. First, the Fed and the FDIC have been approving regional bank resolution plans for nearly a decade, and nowhere do these plans contemplate wholesale acquisition by larger banks. Second, large regional banks have more than doubled their most loss-absorbing capital since the financial crisis, and this dramatically improves their resiliency and decreases the likelihood they would need to be resolved.

Maybe some regulators seem to think that benefits of new requirements always outweigh the costs, but we know regulation is not without cost. And as regulation increases, financial activities will continue to migrate out of the banking system, as they have been doing in recent years.

While some of our banking regulators have been distracted, they have failed to address real challenges facing the financial system. For example, last year the Fed, the FDIC, and the OCC committed to providing greater clarity on the involvement of banks in crypto activities, such as providing custody services or issuing stablecoins.

Well, over a year later, they have provided no public clarity. And during that same period we have seen several high-profile collapses of crypto companies, including a very prominent example just last week.

I think it is very possible that customers harmed by these collapses would have been better off if their crypto assets had been safeguarded by regulated banks that have been providing custody services for other kinds of assets for literally hundreds of years.

But many banks have been pressured—by you—not to provide crypto-related services until your agencies provide this clarity, which just has not been forthcoming. I will note, however, note that Chairman Harper seems not to have pursued this pressure campaign with credit unions. In fact, he has issued guidance for credit unions on partnering with crypto companies, or using distributed ledger technologies.

However, the ambivalence of the remaining agencies has helped to push crypto activities into foreign jurisdictions with weaker or no regulatory regimes. As a general matter, it seems to me the failure of Congress to pass legislation in this space and the failure of regulators to provide clear guidance has created ambiguity that has driven developers and entrepreneurs overseas, where regulations are often lax, at best.

One other item I would like to highlight before we start the rest of the discussion, and it is the deteriorating liquidity in U.S. Treasury market.

In March 2021, the Fed committed to modify the supplementary leverage ratio, or SLR, in part to facilitate bank dealers' ability to

intermediate in this market. Over 18 months later, the Fed still has not acted.

I understand that Vice Chairman Barr has only been in his role for 4 months and he has reasonably suggested that potential amendments to the SLR should be in the context of all capital requirements. I understand that. But we really should recognize that a significant decline in Treasury market liquidity is already occurring, and absent an improvement, I am afraid that the Fed might 1 day decide it has to intervene by restarting bond purchases, which would be quite contrary to its current mission of getting inflation under control.

What I hope to hear from our banking regulators today is that they will prioritize these and other real challenges and not stray beyond their mandates into politically contentious issues or establish unnecessary new regulatory burdens.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Toomey.

I will introduce the four witnesses. Michael Barr took office as Vice Chair for Supervision of the Board of Governors of the Federal Reserve system July of 2022 for a 4-year term. He also serves as a member of the Board of Governors.

Todd Harper was sworn in to serve a full term as the National Credit Union Administration Board Chair in July of 2022.

Martin Gruenberg has been the Acting Chair of the FDIC Board of Directors since February of 2022. He has been previously confirmed to serve as Chair and Vice Chairman of the FDIC, and has served at the FDIC since 2005.

Michael Hsu became Acting Comptroller of the Currency in May of 2021.

Mr. Barr, if you would begin your testimony. Thank you.

STATEMENT OF MICHAEL S. BARR, VICE CHAIR FOR SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BARR. Thank you very much, Chairman Brown, Ranking Member Toomey, and other Members of the Committee. Thank you for the opportunity to testify today on the Federal Reserve's supervisory and regulatory activities.

As Vice Chair for Supervision, my priority is to make the banking system safer and fairer. The banking system is constantly evolving, so regulation and supervision must adjust to respond to new and emerging risks.

Reforms following the global financial crisis have helped the United States maintain a resilient financial system for consumers, businesses, and communities. Capital and liquidity positions remain above regulatory requirements.

But we must ensure we are keeping pace. Many issues at the forefront of banking regulation today when not prominent previously, and some of them scarcely even existed. Few anticipated a global pandemic, and recent events in crypto markets have highlighted the risks associated with new asset classes were not accompanied by strong guardrails.

Turning to a number of our priorities at the Federal Reserve, I am taking a holistic look at the Fed's capital framework to assess

whether it is functioning as intended and supports a resilient financial system. I believe the capital framework should be forward looking, should be tiered so that the highest standards apply to the riskiest firms, and should support a safer and fairer financial system.

In recent years, merger activity and organic growth have increased the size of large banks, which could complicate efforts by regulators to resolve those firms upon failure without disruption to customers and counterparties. The board and the FDIC recently invited comment on an advance notice of proposed rulemaking to enhance regulators' ability to resolve large banks in an orderly way, should they fail.

The Federal Reserve is also evaluating our approach to reviewing banks' proposed acquisitions. Mergers are often a feature of vibrant sectors, but the advantages that firms seek to gain through mergers must also be weighed against the risks that mergers can pose to competition, consumers, and financial stability.

Another priority is monitoring the risk of crypto-asset-related activities. Crypto-asset-related activity requires effective oversight that includes safeguards to ensure that crypto companies are subject to similar regulatory safeguards as other financial service providers.

We are also working to understand financial risks related to climate change. At the Fed, our mandate in this area is important but narrow, and we are focused on our supervisory responsibilities and our role in promoting a safe and stable financial system. To that end, the Federal Reserve recently announced a pilot climate scenario analysis exercise, designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks.

As the banking system continues to evolve, we must ensure that supervision and regulation keep up with those changes and are appropriate for the underlying risks. As Vice Chair for Supervision, I will continue to work to promote a safe and fair banking system.

Thank you, and I look forward to your questions.

Chairman BROWN. Thank you, Mr. Barr.

Mr. Harper, thank you for joining us.

STATEMENT OF TODD M. HARPER, CHAIR, NATIONAL CREDIT UNION ADMINISTRATION

Mr. HARPER. Chairman Brown, Ranking Member Toomey, and Members of the Committee, thank you for inviting me to discuss the state of the credit union system.

While the economic fallout of the COVID–19 pandemic, along with rising interest rates, have influenced credit union performance over the last year, the credit union industry overall remains on a solid footing. At the end of the second quarter, there were just under 5,000 federally insured credit unions with nearly 133 million members and more than $2.1 trillion in assets.

Notably, the industry's aggregate net worth ratio rose to 10.42 percent, representing a recovery of 40 basis points from a pandemic low. Further, the National Credit Union Share Insurance Fund continues to perform well, with no premiums or distributions expected at this time.

During the last year, the NCUA has undertaken several notable actions to strengthen capital, enhance cybersecurity, and support small and minority credit unions. To fortify the credit union system's ability to better withstand future crises, the NCUA implemented its risk-based capital rule along with a simplified compliance option at the start of 2022. The agency also has begun deployment of its new, scalable information security examination program, to allow the NCUA to better evaluate credit union cyber risks.

Further, the agency has increased the resources available in the field to assist small and minority credit unions, and we will soon modify our examination procedures for minority credit unions to better recognize their unique strategies.

Additionally, the NCUA is paying closer attention to consumer financial protection, which buttresses and complements our safety and soundness efforts. This year, NCUA examiners are reviewing compliance with pandemic assistance programs, fair lending rules, servicemember protections, fair credit reporting laws, and overdraft programs. We have also increased the resources for fair lending supervision.

And as we move into 2023, the NCUA is emphasizing that all credit unions remain vigilant in managing safety and soundness and consumer financial protection to prepare for rising interest rates, inflationary pressures, liquidity concerns, and cybersecurity risks.

Additionally, as the financial services system and credit unions continue to evolve, especially with many credit unions growing larger and more complex, the industry's regulatory framework must keep pace to maintain the strength and stability of the credit union system.

In response to these changes and to legislation recently enacted into law, the NCUA has undertaken several rulemakings and implemented new rules during the last year. These rules address member expulsion procedures, subordinated debt, emergency capital investments, and cybersecurity notifications.

Finally, I want to highlight two legislative changes that would help the agency better fulfill its statutory mission. Most timely, the NCUA requests a permanent adjustment to the agent member requirements for the Central Liquidity Facility. Notably, the extension of this enhancement comes at no cost to the taxpayer, as scored by the Congressional Budget Office.

Currently, corporate credit unions may serve as an agent for a subset of their members, but without legislative action, by year's end, 3 out of every 4 credit unions, including most minority credit unions, will soon lose their access to an important Federal liquidity backstop, and the credit union system's capacity to address liquidity events will shrink by $10 billion. With growing interest rate risk and rising liquidity concerns, now is not the time to decrease the access to the system's liquidity shock absorbers.

The NCUA is also seeking restoration of its ability to oversee third-party vendors. This statutory change would provide the NCUA parity with other agencies that supervise and regulate federally insured depository institutions. This examination authority is critical, given the system's increased reliance on third-party ven-

dors and credit union service organizations. The Government Accountability Office, the Financial Stability Oversight Council, and the NCUA's Office of Inspector General have all recommended that Congress restore the NCUA's vendor authority.

The U.S. House of Representatives has passed legislation as part of the 2023 National Defense Act to reinstate the NCUA's vendor authority, and in the Senate, bipartisan legislation has been introduced for which I would like to thank Senators Ossoff, Lummis, and Warner. Their bill, the Improving Cybersecurity of Credit Unions Act, would close a growing regulatory blind spot.

That concludes my statement. I look forward to your questions.

Chairman BROWN. Thank you, Mr. Harper.

Mr. Gruenberg, welcome.

STATEMENT OF MARTIN J. GRUENBERG, ACTING CHAIR, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Chairman Brown, Ranking Member Toomey, and Members of the Committee. I very much appreciate the opportunity to appear today at this hearing on the oversight of the financial regulators.

In my oral remarks today I would like to focus on the state of the U.S. banking industry and the outlook for the industry. To begin with, the U.S. banking industry today has reported generally positive results for this year amid continued economic uncertainty. Loan growth strengthened, net interest income grew, and most asset quality measures improved. Further, the industry remains well capitalized and highly liquid.

The number of institutions on the FDIC's "Problem Bank List" remained stable in the second quarter of this year, at 40 institutions. That is actually the lowest number since quarterly reporting of that data began in 1986. Fourteen new banks opened through October 2022, including the first mutual bank in 50 years. And additionally, no banks failed during 2021, nor this year as well.

At the same time, the banking industry reported a moderate decline in net income in the first two quarters of this year from a year ago, primarily because of an increase in provision expense at the largest institutions, and that is worth paying some attention to. The increase in provision expense, that is the amount set aside by institutions to protect against future credit losses. It reflects the banking industry's recognition of risks related to persistent economic uncertainties and slowing economic growth as well as the increase in loan balances.

Rising market rates and strong loan growth supported an increase in the banking industry's net interest margin from the first to the second quarter. As a result, most banks reported higher net interest income compared to a year ago.

However, rising interest rates and longer asset maturities also resulted in unrealized losses on investment securities held by banks, and there is a significant overhang here. As of the second quarter of 2022, banks reported $470 billion in unrealized losses as the market value of securities fell below the book value. The FDIC expects this trend to be an ongoing challenge, as interest rates continue to rise in the third quarter, especially if banks should need to sell investments to meet liquidity needs.

In summary, despite favorable performance metrics, the banking industry continues to face significant downside risks that we need to pay attention to. These risks include the effects of inflation, rising market interest rates, slowing economic growth, and continued geopolitical uncertainty. Taken together, these risks could reduce profitability, weaken credit quality and capital, and limit loan growth in coming quarters.

Further, as I mentioned, higher market rates have led to continued growth in unrealized losses in the banking industry's securities portfolios. Higher rates may also erode real estate and other asset values as well as hamper borrowers' loan repayment ability. So these are all matters that we will be paying, at the FDIC, close attention to over the course of this year and next.

In my written testimony I provide an overview of the condition of the FDIC's Deposit Insurance Fund, and the reason behind the FDIC's decision to increase deposit insurance assessments by 2 basis points next year, to avoid a potentially larger, more procyclical increase later, at a less favorable point in the economic cycle.

I also update the Committee in my written testimony on five key policy priorities for the FDIC: strengthening the Community Reinvestment Act; addressing the financial risks that are likely to affect banking organizations and the financial system as a result of climate change; reviewing the bank merger process; evaluating the risks of crypto assets to the banking system; and finalizing the Basel III capital rules.

I also discuss the FDIC's efforts to support minority depository institutions and community development financial institutions, promote a diverse and inclusive workplace at the FDIC, strengthen cybersecurity and information security within the banking industry, and the FDIC's recent return to in-person banking examinations and other in-person activities at every level of the agency.

I would be glad to respond to questions from the

Committee on these or any other matters. Thank you.

Chairman BROWN. Thank you, Mr. Gruenberg.

Mr. Hsu, welcome.

STATEMENT OF MICHAEL J. HSU, ACTING COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. HSU. Chairman Brown, Ranking Member Toomey, and Members of the Committee, I am pleased to appear before you today to provide an update on the activities underway at the OCC.

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

Since my appointment, to fulfill this mission we have focused on four priorities—guarding against complacency, reducing inequality in banking, adapting to digitalization, and managing climate-related financial risks. My written statement describes the progress the OCC has made on each of these. Here I would like to focus on how we are helping to ensure that banks serve the needs of their communities.

First, I want to highlight the OCC's commitment to community banking. We are taking specific actions to support community banks, including revitalizing minority depository institutions, reducing community bank assessments, promoting de novo startup banks, and tailoring regulation based on size and complexity.

Second, the OCC continues to encourage the banks we supervise to improve their products and services, including overdraft programs, with their customers' financial health in mind. Many of these banks, including nearly all of the largest banks, have begun reforming their overdraft programs and lowering fees. While more work needs to be done, consumers are benefiting from the efforts of national banks to reduce penalty fees and the daily number of overdrafts charged, to provide grace periods before fees are imposed, and to end nonsufficient funds fees. By some estimates, changes at the largest national banks could save consumers billions of dollars annually.

Additionally, the OCC has strengthened its supervision of compliance with fair lending laws. We recently updated our process for screening bank retail lending activities to provide more risk-focused fair lending examination strategy to identify weaknesses or wrongdoing. Where we find evidence of potential discrimination, we refer those matters to DOJ and HUD, as applicable. Redlining and other forms of lending discrimination are unacceptable, especially in this day and age, and we will not hesitate to take enforcement action, if necessary.

The OCC, in coordination with the Federal Reserve and FDIC, as well as the DOJ, is also considering updates to the framework for analyzing mergers under the Bank Merger Act. This is to ensure that resulting entities continue to meet the convenience and needs of the community, support financial stability, enhance competition, and are safe and sound. The OCC considers each merger application on its merits against these statutory factors and associated regulatory criteria. We are planning a public symposium in February to explore this important issue further.

As the digitalization of banking accelerates and bank-fintech partnerships grow, the OCC is focused on ensuring that our expertise and regulatory framework adapts so that safety, soundness, and fairness of banking is maintained and even strengthened. We recently announced that we will be establishing an Office of Financial Technology early next year, building upon the work and successes of the agency's Office of Innovation, which was created in 2016. This change will enable us to engage more substantively with nonbank technology firms and to better supervise bank-fintech partnerships so that we can help ensure that consumers of banking services are treated fairly as well as help maintain a level playing field as the industry evolves.

With regard to crypto, the OCC has adopted a careful and cautious approach. Last November, we issued guidance which reminds the banks we supervise that they are not permitted to engage in certain crypto activities unless they can perform these activities in a safe and sound manner. This approach helped to mitigate the risks of contagion from crypto to the Federal banking system after the collapse of Terra Luna this spring as well as more recently with the bankruptcy of FTX.

Finally, let me say a few words on climate-related financial risks. The OCC's approach is firmly rooted in our mandate to ensure that national banks operate in a safe and sound manner. It is not our role to tell bankers who to bank or not to bank. We do not pick winners and losers. Rather, our focus is on risk management and making sure banks, especially large banks, have the necessary capabilities to identify, measure, and monitor their risks. We are committed to staying in our safety and soundness lane, not on setting industrial policy. This is important to our credibility as a safety and soundness supervisor.

In closing, I remain committed to ensuring that OCC-supervised banks operate in a safe, sound, and fair manner, meet the credit needs of their communities, and comply with applicable laws and regulations.

I look forward to answering your questions. Thank you.

Chairman BROWN. Thank you, Mr. Hsu. Thanks to the four of you.

This year we have seen cryptocurrency values collapse by $2 trillion, two thousand billion dollars, and markets crash, crypto exchanges implode, file for bankruptcy, investors losing their money, workers losing their jobs. The parallels to past financial crises through our history are troubling, from wildcat money in the mid-1800s to the dot-com bubble burst in the 1990s to the over-the-counter derivatives that led to the 2007–2008 financial crisis.

Unlike traditional bank or credit union deposits, which Americans use to get paid, buy necessities, build their savings, private cryptocurrencies are not backed or protected by the Government, and they should not be. We have seen them used for speculation and fraud and scams, sanctions evasion, outright theft. There does not seem to be anything useful or beneficial, that hundreds of speculative cryptocurrencies can be used for.

Since I have been Chairman of this Committee for close to 2 years, many on my side of the aisle have raised warning flags about this. The last thing we need is for risky new financial products to crash our financial system. Thank you, those of you on this panel, for your skepticism about cryptocurrencies, and we will continue that work.

As all of you pointed out, digital assets pose risks to our financial system. There are many other risks we need to focus on to ensure the banking and credit union system is resilient for consumers and small business owners.

So a question for all four of you. What are the biggest risks that your agencies see? How could they harm working families and small businesses on Main Street? What are your agencies doing to protect against them?

I will begin with Mr. Harper, then Mr. Gruenberg, then Mr. Hsu, then Mr. Barr. So if you would answer. Each of you take a moment or so and answer those questions.

Mr. HARPER. Certainly. Generally I see four risks that are coming down the line. First is interest rate risk for the institution itself, second is liquidity risk, the third is cybersecurity risk, and something that we are watching on the horizon would be credit risk that happens, particularly as unemployment rises. There is a correlation in the numbers that shows that as unemployment rates go

up we often see an increase in charge-offs and defaults. That is something that we are going to be watching very closely, moving forward.

Chairman BROWN. Thank you. Mr. Gruenberg.

Mr. GRUENBERG. Thank you, Mr. Chairman. I think, first and foremost, as I outlined in my oral statement, I do think we are at an inflection point here in the economy with the Fed having shifted the conduct of monetary policy, and we have a rising interest rate environment. And I do think that presents a number of potential downside risks to the banking system that I outlined earlier.

I think our institutions are going to have to pay close attention to the interest rate risk that is accumulated on their balance sheet, both through longer-term assets that they have accumulated. I mentioned in particular the unrealized losses on securities on their balance sheets. And I also think there are asset exposures that our institutions have, particularly in commercial real estate, which we have had experience with during other times of potential economic and financial stress, as well as in the mortgage market.

So I think from a supervisory standpoint, with the changing economic environment as financial regulators and banking regulators, we are going to have to pay close attention, in particular, to these developing issues.

Chairman BROWN. Thank you. Mr. Hsu.

Mr. HSU. So I think the greatest risk is the risk of complacency. The risks that are facing the banking industry are fairly well known at this point—interest rate risk, credit risk, operational IT risk, cyber risk. The risk that banks are facing is that they are not paying sufficient attention and vigilance to that as we deal with other, more headline risks, such as crypto.

There are some tail risks that are also out there that we need to pay attention to, geopolitical in the commodities space, nonbank financials. There are also well known and have been identified by the FSOC and others. So I just encourage banks and supervisors to stay on top of those. Thank you.

Chairman BROWN. Thank you. Mr. Barr.

Mr. BARR. Thank you. Like the others, we are paying careful attention to the way in which supervised institutions are managing liquidity risk and interest rate risk. Cybersecurity is always an issue to be watchful for.

We are worried about making sure that financial institutions are thinking about potential risks if the economy softens, so particularly as others have said, in commercial real estate, residential housing, which are the sectors most often that are leading indicators for risk in that area.

We are paying attention to longer-term risks as well. We talked, I think all of us, about the longer-term risks with respect to climate change. Events abroad might cause disruptions in the United States. The war in Ukraine, Russia's war in Ukraine obviously is devastating for the people of Ukraine and also creates enormous potential risks in Europe and elsewhere.

And we are paying careful attention to risks in China as well, with slowing growth there and a political turn inward that may cause additional risk to happen.

And last, we are concerned about the risks that we do not know about in the nonbank sector. That includes, obviously, crypto activity but more broadly risks in the parts of the financial system where we do not have good visibility, we do not have good transparency, we do not have good data. That can create risks that blow back to the financial system that we do regulate, and so we pay careful attention to understanding those risks as best we can.

Chairman BROWN. Thank you. Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman. I want to follow up on a comment the Chairman made. I think I heard the Chairman refer to crypto as risky new financial products, and the insinuation was that they might have the ability to crash our financial system.

I think there is a really important distinction that I want to underscore here. If you look at what happened with FTX, what at least appears to have happened by a very extensive coverage, this is fundamentally not about the kind of assets that were held by FTX. It is about what individuals did with those assets.

There are a lot of corollaries. There are a lot of analogies here. One comes to mind. In 2011, MF Global, a commodity brokerage firm that was run by former New Jersey Senator John Corzine. It collapsed after customer funds were misappropriated to fill a shortfall caused by the firm's exposure to some trading that went south. Now nobody suggested that the problem was the instruments that were used. The problem was the use of customer funds.

Similarly, the 2008 financial crisis involved disastrous consequences with what people were doing with mortgages. Did we decide we have got to ban mortgages? Of course not.

So let us look at FTX. It certainly appears to be an egregious failure to treat customer assets as segregated assets. It appears at the leadership there attempted to fill a hole at an affiliated company, and it occurs to me that this is a worry that I do not have for one split second about my stocks or my bonds or my Treasuries when they are held in custody by American banks.

Mr. Hsu, a predecessor of yours said that there is no need for any additional guidance. It is a settled matter as to how banks should custody financial assets, and they do it all the time, and they have done it forever.

But my understanding is that your office discourages banks from providing custody services, among other services in the crypto space. And it seems to me if people had access to custody services provided by a wide range of institutions, including regulated financial institutions, they might be able to sleep more comfortably knowing that those assets were unlikely to be used for some completely inappropriate purpose.

So is it true that you discourage banks from engaging in crypto custody services?

Mr. HSU. We discourage banks from doing things that are not safe, sound, and fair. And so the custody that you described of traditional assets, it is true banks have been doing that for a long time.

Senator TOOMEY. Right.

Mr. HSU. They know how to do that. We know how to do that.

The custody of crypto is different. There are some underlying, fundamental issues and questions regarding what does it mean to

own crypto through a custody, which have not been fully worked out.

Senator TOOMEY. So this activity, crypto trading, people holding crypto assets, has been going on for many years. Why have you not provided the clarity? Why have you not provided guidance so that it is clear and we could have customers have the assurance of having their assets stored by reliable institutions?

Mr. HSU. If banks can demonstrate that they can do that activity in a safe, sound, and fair manner, we are all ears.

Senator TOOMEY. But I think some of this obligation is on you to provide some clarity about how that could work, and as I say, what I am hearing from the industry is that this activity is being discouraged. And the result is not that the activity does not occur. It is just that it goes somewhere where the regulation is often lax.

Let me move on to another aspect of this. Vice Chairman Barr, you recently said that there are types of crypto-related activities where the Fed may need to provide guidance to the banking sector. In your view, is custody a category of crypto activity that the banking sector can provide and could use some guidance?

Mr. BARR. Thank you, Senator Toomey. I do think that it would be useful for us to provide guidance to the banking sector about how to safely custody crypto assets. It is something I look forward to working with my colleagues on.

I think we have seen, in the context of recent events, that if you have a set of firms that are trying to operate outside the regulatory perimeter, trying to avoid compliance issues, that can create enormous problems for consumers, for investors. There are huge problems that these investors experience that I do not think anyone wants to see happen.

Senator TOOMEY. Just a quick follow-up here. My understanding is the SEC has put out guidance recently that would require issuing firms that custody crypto to put that crypto on their own balance sheet. Now that is contrary to the way custody services are treated in every other category of asset that I can think of, and always has been.

If that were the case, if you are a firm that does not care about having a bloated balance sheet, maybe you do not care, but banks have a reason to be very concerned about increases in their balance sheet because it has capital requirements.

Would this not impose a significant cost on banks if they are, in fact, obligated to put all of the crypto custody assets on their balance sheets?

Mr. BARR. Well, we have seen bank operate in a pretty cautious way to date. There are very few institutions that are currently seeking to engage in custody activity. Of course, we require all of our regulated financial institutions to comply with accounting rules, including accounting interpretations issued by the SEC. And so publicly traded banks would need to comply with that rule, and it would have the result that custody of crypto assets, you would need to hold capital against——

Senator TOOMEY. In a way that is not required of any other category of financial assets.

Mr. BARR. ——in a way that is not required for traditional custody of non-crypto assets. So that differential would impact bank decisionmaking.

Senator TOOMEY. Yeah. Thank you very much.

Senator REED [presiding]. Thank you, Senator Toomey.

On behalf of the Chairman I will recognize myself.

Gentlemen, thank you for being here today. Vice Chairman Barr, the Volcker rule prohibits Wall Street banks from making investments in hedge funds and private equity funds. The legislation was passed in 2010, with the hope that those investments could be liquidated quickly. But there are some that were deemed to be too illiquid or too difficult to be dispensed with immediately, and so there was an extension to July 2022, 12 years. And yet there are at least two institutions that still have not disassociated themselves and disinvested.

You have given them extra time. Is this going to be an endless process, or why can they not get it done?

Mr. BARR. Senator Reed, thank you. I agree with you. I think the time has come for those divestments to happen. The Volcker rule provided, as you said, until July of this past year to get that done. Some firms, I believe, were erroneously relying on a legal interpretation that would not require them to do those divestitures. I think that is an incorrect legal interpretation. We will be clear with them that it is time to get those divestitures done. Some of them may need a small amount of time to get that done, but we are not going to see continued extensions beyond that.

Senator REED. Thank you very much.

Mr. Gruenberg, when the Fed raises interest rates, historically, banks usually follow with their savings rates. In fact, according to industry research the deposit rate should start ticking up when the Fed's target rate hits about 1.33 percent. Well, the Fed's target rate is now 4 percent, and the national average interest rate on a savings account is now 0.2 percent. But the Nation's biggest banks are even lagging that average. They are at 0.01 percent.

So why do you think the biggest banks have been lagging so much in terms of sharing their beneficence with their savers?

Mr. GRUENBERG. Thank you, Senator. It is pretty clear that the banking industry is trying to take advantage of rising interest rates on the credit product side, to increase earnings, and it is fair to say what they are paying out on the deposit side has lagged that. We will see if competitive pressures within the industry impact what they may offer on deposit accounts, but right now there is clearly a lag.

Senator REED. Thank you. Let me follow up with another question, Mr. Gruenberg. There has been a situation where banks are partnering with fintech companies. It has been described as "rent-a-bank," where the fintech company comes in and uses the bank as an intermediate to avoid usury limits and other restrictions. Many of these are your institutions.

What are you doing to try to stop that?

Mr. GRUENBERG. Thank you for the question, Senator. When a bank partners with a third party and the third party is providing services on behalf of the bank, including credit products, as a supervisory matter the offering of services by the third party are

treated as if the bank itself is offering those services and products, and the bank is supervised accordingly.

We have a number of institutions that are utilizing partnerships to benefit from the banking relationship. There are several institutions I will say we are taking a close look, particularly at the lending activity going on, to ensure that the lending activity is being appropriately underwritten and that it is based on the borrower's ability to pay as well as consumer protection requirements in terms of disclosure and transparency are being complied with. And this is a matter of attention for us, and I appreciate you asking the question.

Senator REED. Well, thank you very much.

Now, on behalf of Chairman Brown, let me recognize Senator Rounds.

Senator ROUNDS. Thank you, Mr. Chairman. Vice Chair Barr, welcome back to the Committee and congratulations on your confirmation.

In recent speeches you have announced that you would be conducting a holistic review of the capital framework for our financial institutions. Included in that evaluation will be a review of the supplementary leverage ratio, or SLR, the countercyclical capital buffer, and stress testing. This review is long overdue as the Fed has said for months that it would reassess both the G–SIB surcharge and the SLR.

In the process it is important that we strike a balance between financial stability and economic growth. In order to achieve that balance, I believe the Federal Reserve must be transparent and consider input not only from Congress but from stakeholders on any adjustments.

When do you expect this review to be complete, and will you commit to providing a transparent, formal, public process with a comment period for any resulting adjustments to SLR, the G–SIB surcharge, stress tests, or countercyclical capital buffer?

Mr. BARR. Thank you, Senator Rounds. We are conducting that review now. We are in the middle of that. I expect that early next year we will be able to say more about where we are in that process.

If any of these parts of the review require us to rethink a rule, like the eSLR or the countercyclical capital buffer and the like, we would, of course, seek public comment as part of that process. We will issue a proposal, get comments in, evaluate those comments, understand them, and then lead to any action we took on a final rule. So we would follow normal process on that.

Senator ROUNDS. Thank you.

Chair Harper, late last year the NCUA approved its 2022–2026 Draft Strategic Plan, which included an analysis of the internal and external environment impacting NCUA and evaluated the agency's programs and risks. It included language suggesting that as a result of changing weather disproportionately affecting farming communities credit unions should consider adjustments to their membership. This was very problematic language as it implied that credit unions that primarily serve agricultural communities may have to alter their memberships or face increased costs and regula-

tions. As a result of the actions of Senator Cramer and myself, that language thankfully was not included in the final draft.

Chair Harper, will you commit to avoiding similar problematic language in future strategic plans and commit to not punishing credit unions for supporting their local farmers, ranchers, and agribusinesses in their communities?

Mr. HARPER. Yes.

Senator ROUNDS. Thank you.

It has been widely reported that the CFPB is planning to shift liability for peer-to-peer payments that consumers make to a scammer. Scammers would likely profit from such a policy because armed with an official Government document they will be able to induce people to pay them by telling them there is no risk in sending the money, even if the circumstances are suspicious. However banks, unlike the consumer, would have no insight into the transaction to be able to stop it.

My question for Vice Chair Barr, are you concerned there will be an impact on bank safety and soundness given banks' inability to identify or stop the fraud the size of potential fraud losses banks could incur, and furthermore, has there been any research done to determine how fees would increase and what new costs consumers would bear if this is implemented?

Mr. BARR. Thank you, Senator Rounds. The regulations that issue Regulation E are implemented by the Consumer Financial Protection Bureau, so in the first instance I think it makes sense for them to figure out what they would like to propose, if anything, in that area, and then we would be able to understand the implications of that proposal more broadly. But I do not have any further insight about it at this time.

Senator ROUNDS. No existing studies at this point?

Mr. BARR. I do not know the answer to that. None that I am aware of, but there may be others that exist that I do not know.

Senator ROUNDS. Thank you.

Following an influx of deposits generated by Government stimulus, the FDIC approved an aggressive proposal to uniform increase bank deposit insurance assessment rates by 2 basis points until the Deposit Insurance Fund reached a designated reserve ratio of 2 percent. This proposal has the potential to disproportionately harm community banks by forcing them to pay between 5 percent and 25 percent of their pretax income for insurance assessments. Meanwhile, the OCC recently approved a 40 percent reduction in assessments for OCC-chartered community banks.

Acting Chair Gruenberg, could you please explain your logic behind supporting increases to community banks' FDIC deposit insurance assessment rates well beyond the statutory requirement, and was a study done to determine the ratio of 2 percent, or is that an arbitrary number?

Mr. GRUENBERG. The 2 percent was the subject of careful analysis and was reached based on the FDIC's experience during two crises. And just to be clear, if I could take a moment to explain because it is a little complicated, under the statutory requirement there is a minimum reserve ratio for our Deposit Insurance Fund of 1.35 percent, and if that ratio falls below, the FDIC is required

by law to establish a restoration plan to bring it back up to the 1.35 percent minimum.

As you noted, at the beginning of the pandemic there was an inflow of insured deposits and it pushed the ratio down, and the FDIC, back in 2020, adopted a restoration plan that did not envision increasing assessment rates. That was based on an expectation, frankly, that as the pandemic progressed the growth in insured deposits would slow down. And what occurred is that over the past year, from the second quarter of this year to the previous, the insured deposit growth rate remained very high, at 4.3 percent.

So we had projections that envisioned us being able to restore the reserve ratio fund to the statutory minimum, by the statutory deadline of 2028. We thought we could do that without an assessment adjustment. Because the growth rate stayed high it shifted our projections and really put in question whether we could get to the minimum in time.

So we had a tricky call to make, and let me be candid, we could have delayed and hoped that the growth in insured deposits would slow down and the problem would take care of itself. The problem there—and I will come quickly to a conclusion—was that if we were wrong we then might have to impose a larger assessment on the industry, at a later stage of the cycle, when the industry would be in a not as good a position to absorb it. So we opted for a 2-basis-point increase. That is about 1.2 percent of industry income. We did not envision that impacting lending or credit availability, but it would assure us of putting the fund in a solid position, particularly since we are heading into an uncertain period.

So it was a tricky call, but that was the judgment we made.

Senator ROUNDS. Thank you, Mr. Chairman, for your indulgence on that.

Senator REED. Let me, on behalf of Chairman Brown, recognize Senator Menendez.

Senator MENENDEZ. Thank you.

The collapse of FTX last week is the latest in a series of high-profile crypto collapses this year, which have left investors locked out and facing uncertain prospects for recovering their money. This should be a renewed call for Congress to take a serious look at crypto exchanges and lending platforms, many which engage in risky behaviors while marketing themselves as safe for consumers.

Mr. Gruenberg, am I correct in saying there are no cryptocurrency firms backed by the FDIC?

Mr. GRUENBERG. That is correct.

Senator MENENDEZ. In fact, at this time FDIC insurance does not cover cryptocurrency of any kind. Is that correct?

Mr. GRUENBERG. That is correct, Senator.

Senator MENENDEZ. Many of these firms are marketing themselves to consumers as safe and responsible while engaging in risky behaviors without the guardrails and safety nets that exist within the traditional financial system. In August, the FDIC issued letters demanding several crypto firms, including FTX, cease and desist from misleading consumers into believing their deposits were insured. The FDIC and Federal Reserve issued a similar letter in July, to Voyager LLC, which collapsed earlier that month.

What can we do to combat misinformation like this and better protect and inform consumers in the crypto space?

Mr. GRUENBERG. Thank you, Senator. Listen, this has been a key priority for us. The strength of the FDIC is the public's confidence in our deposit insurance system, so if that confidence is put in question it really puts the system at risk. And if we have financial players who are engaging in blatant misrepresentation in regard to deposit insurance coverage, that is not only a violation of the law by firms that do that, it really is a threat to the credibility of the FDIC and our deposit insurance system.

So when we identified some companies, in the crypto space and others, engaging in misrepresentation, we acted very forcefully in sending letters demanding that they cease and desist, and indicating that if they did not comply we have enforcement authorities available to us under the law that we can bring to bear. We thought it was important in regard to those individual actors, and we thought it was important to send a message to those who would think about engaging in misrepresentation of deposit insurance coverage.

Senator MENENDEZ. Well, I am glad you did, and I think these exchanges having these troubles should instigate us and regulators to look at what regulations are needed to ensure investors in the overall financial system are protected.

I want to thank all of you for jointly proposing a rule to modernize the CRA to increase lending in minority communities. We saw, 2 years ago, an assault on the CRA when the OCC acted alone and proposed a rule that would have left minority communities with less credit, and I thank Comptroller Hsu for withdrawing that rule.

According to the Census Bureau, there are over 26 million limited English-proficient consumers in the United States, with 17 million of those consumers speaking predominantly Spanish.

So Mr. Barr, Mr. Hsu, Mr. Gruenberg, do you all agree that language can be a barrier to assessing financial services?

Mr. GRUENBERG. Yes.

Mr. BARR. Yes.

Senator MENENDEZ. Would you all agree that, for example, home mortgage loans and small business lending could increase in Hispanic communities if banks provided more documents and in-person services in Spanish?

Mr. GRUENBERG. Yes.

Mr. BARR. Yes.

Mr. HSU. Yes.

Senator MENENDEZ. I hope you will all consider seriously in your services test an evaluation of a bank's ability to serve those with limited English proficiency. In August, I joined Chairman Brown and 17 of our colleagues in a comment letter, urging you to include this in your final rule. Incentivizing banks to offer more services in, for example, in Spanish, will increase banks' ability to diversify their staff, something the banks still often fail to do. With a $1.8 trillion domestic marketplace this would make a lot of sense for the banks as well as for the community. They take their deposits and they should be also willing to work with them.

Finally, Vice Chair Barr, as you know, the Federal Reserve has again the opportunity to appoint a Hispanic to a Federal Reserve bank president at either the Kansas City or Chicago Federal Reserve bank. In its 108-year history, the Federal Reserve has never had a Hispanic Federal Reserve bank president.

During your confirmation process you made a commitment to develop a transparent process with meaningful public input on the selection of Federal Reserve leadership. I suggested six ideas to strengthen the Federal Reserve bank director and president selection process. You agreed at that time with all of them. Can you tell me what specific actions have you taken to implement any of those reforms?

Mr. BARR. Thank you, Senator. First of all, let me just start by saying there is a lot more work that has to happen. I think it is good that you have pointed out this issue and continue to point it out to the Federal Reserve.

There have been a number of positive steps that I have talked through with my colleagues at the Board. There has been progress in recent searches on the public posting dissemination of position descriptions and webinars and town halls to get public input. The public has, in these recent searches, undertaken solicitation of nominations, ideas from the public for individuals. There has been, in recent searches, engagement with public service organizations, with civil rights groups, with community organizations.

There has not yet been progress on one of the items that you suggested. That is public release of demographic information. And we are also considering the suggestion that you made but have not taken action yet with respect to getting public input on the process itself at the Board or bank level.

So we have made some progress but we are still seeing a lot more work to do.

Senator MENENDEZ. Well, let me just close by saying anonymized data is something that should not be so hard but would give us a window into the process, and the proof, ultimately, will be in whether or not there is a selection of a qualified individual, for which I believe there are many candidates.

Thank you, Mr. Chairman.

Chairman BROWN [presiding]. Senator Tillis, of North Carolina, is recognized.

Senator TILLIS. Thank you, Mr. Chair. I have to start today by expressing my concern with President Biden's nomination of Mr. Gruenberg to serve as the FDIC chair. Mr. Gruenberg appears before us today on an anniversary, 10 years to the day of his confirmation to a 5-year term. Despite the fact that his term has long expired, Mr. Gruenberg has remained at the FDIC, most recently acting as chairman, despite not being confirmed by the Senate for a decade.

During Mr. Gruenberg's tenure as FDIC chairman, the agency has had a severely blemished record, most notoriously Operation Chokepoint, which sought to debank legal but politically disfavored businesses. Additionally, there were reports of mistreatment of employees and some allegations of racial discrimination in hiring.

And just last year, while continuing to serve on the FDIC board, despite his long-expired term, Mr. Gruenberg helped facilitate a

partisan power grab of the FDIC board. He, along with his fellow Democratic board members, blatantly discarded the FDIC's 90-year precedent of allowing the FDIC chairman to set the agency's agenda, and in the process forced out Chair McWilliams.

Until last year's coup, all previous FDIC board members, Democrat and Republican alike, had followed the agenda-setting precedent. That is something Acting Chairman Gruenberg knows quite well. At the beginning of the Trump administration, he served as FDIC chairman. Although Republicans outnumbered on the board, they followed precedent and allowed him to set the agency's agenda. However, when the shoe was on the other foot, Mr. Gruenberg facilitated the erosion of FDIC independence, not unlike attempts here to nuke our Senate filibuster.

We need nominees, at the FDIC and other agencies, who will uphold the long history of bipartisanship and political independence at Federal financial regulators. Unfortunately, I have drawn the conclusion that Mr. Gruenberg does not fit that bill.

Now, Mr. Barr, by the Fed's own measures in recent financial stability report, the bank sector continues to be well capitalized. The Fed reports that the results of the 2022 stress test indicate, I quote, "large banks would maintain capital ratios well above the minimum risk-based requirements, even during a substantial economic downturn."

But now it is widely expected that the upcoming Basel capital proposal will significantly increase capital requirements. I am not one of these members who say, "Give me a simple yes-no answer," but something close to that to these next three questions would really be appreciated.

Do you believe capital levels are not strong enough?

Mr. BARR. Thank you, Senator. I am engaged in a holistic review of all the capital requirements to see not only whether they are strong but whether they are strong enough and how they work well together, are they fitting together in a way that serves the interests of making the financial system safe. I do not have a conclusion yet to that holistic review. I am undertaking it now and I will have more to say about it in the first quarter of next year.

Senator TILLIS. The analysis of the stress testing, though, seems to think that you are reasonably confident that current capital ratios are OK. So what is going to ultimately tip the scales to a different conclusion and maybe embrace the Basel report?

Mr. BARR. Thank you. We are looking really at all the factors, so the stress test is one important input into that. It, of course, determines the level of capital, so it is setting capital requirements in the course of deciding that the capital requirements are sufficient. The reason that it does that is because of the presence of the stress capital buffer.

And so the stress test is one input into that. We are modeling, of course, not a prediction about the future but one scenario that banks might need to address, and so that is an important factor but not the only factor. We need to look at risks across the system. As I indicated in my testimony, for example, before the global pandemic hit in March of 2020, that was not on anybody's list of potential risks to the financial system.

Senator TILLIS. Just a quick question. So if economic activity continues to slow and we increase capital requirements, is there a scenario where that is a good thing?

Mr. BARR. Well, I am not——

Senator TILLIS. Or what would be a scenario where it is a good thing?

Mr. BARR. ——I am not reviewing capital requirements to think about what the right capital level should be tomorrow. I am trying to think about how we should set capital requirements over time, through economic cycles. For any capital rule there is a process. We will do a proposal and we will issue a final rule, and then there is an implementation period. So we are not trying to think about, you know, what capital should be tomorrow. We are trying to think over long periods of time what are the right capital levels in the system.

Senator TILLIS. OK. Well, thank you all for being here and I will submit other questions for the record. My time has expired. Thank you, Mr. Chair.

Chairman BROWN. Senator Tester, of Montana, is recognized.

Senator TESTER. Yeah, thank you, Mr. Chairman. I want to thank you all for being here in front of the Committee today. I appreciate your leadership and your guidance.

In particular, I was not going to talk about crypto but I particularly appreciate your common-sense approach on safe and sound and fairness, especially you, Mr. Hsu. All of you are good on this.

Look, I remember the meltdown in '07, Mr. Chairman talked about it, where we had synthetic financial instruments and maybe being attached to mortgages, but there was no there, there. And it ended up where we cut a pretty damn big check of taxpayer dollars to solve that problem. And I am going to tell you, if you guys would have given guidance, and you had given credibility, we would be cutting another check. And so I just want to say thank you. I do not say that as a lawyer or an accountant. I say it as a farmer. Thank you. Thank you for what you have done.

During a hearing last year I had talked to Mr. Hsu and Chairwoman McWilliams about the Community Reinvestment Act and the changes that were going to happen in making sure that rural America and our native populations, the investments would be made better in those countries. So the comment period has ended. It has not taken effect yet. But for Misters Gruenberg and Hsu and Barr, could you tell us how the new rules are going to ensure investment in rural America? Go ahead, Mr. Gruenberg.

Mr. GRUENBERG. Thank you, Senator. I will say that was a real focus of attention for the three agencies in developing the rule, how we could utilize CRA to provide incentives for increased bank lending and investment in rural communities and Native American communities, which are historically underserved and lack access to basic banking services.

We did that through proposed changes in the two key tests under CRA, both the lending test and the community development test, by providing greater flexibility. We are not limiting the lending test just to the traditional branch-based assessment areas but we have a statewide dimension to the test which will give banks additional credit for serving rural communities as well as Native Americans.

And we provide significant greater flexibility in the community development test, so that banks can invest in underserved rural communities and Native American communities and get CRA credit for it, even though it is not part of their branch network. So these were key flexibilities that we think will be helpful.

Senator TESTER. You fellas, anything else you would like to add to that? Go ahead.

Mr. HSU. I would say, in addition to the CRA, at the OCC, Native American issues are a top priority. We have a Project Reach, which is to increase financial inclusion. We have had a special subcommittee focused on home ownership promotion for Native Americans. Because of some of the legal issues it is tough for banks, so we held a webinar, trying to move that ball forward there.

And I met recently with Treasurer Malerba, who is the head of the Office of Indian Affairs, to see how the OCC and her office can work together to promote these issues.

Senator TESTER. Do you see any positive impacts on housing with the changes in the CRA in rural America?

Go ahead, Mr. Barr, if you want to talk.

Mr. BARR. I think, obviously, the rule is not yet into effect, but I think that we would see improvements on housing in rural America and on community development in rural America. And I also just emphasize the point that both Marty and Mike made, that the issues affecting Native American communities' access to financial services are longstanding. They have been problems for generations. And if we do not take seriously the need to fix those problems, including with the reforms of the Community Reinvestment Act, Native American communities are going to continue to be left behind. So I think it is really a critical issue to be working on.

Senator TESTER. So before the pandemic started I talked with your predecessors about what I have been hearing from bankers in Montana about the ag industry. The previous Administration had some pretty silly trade wars and it affected ag commodity prices in a big way.

We have seen ag prices increase dramatically, but we have also seen input costs increase dramatically. So based on your examiners, what are you seeing from the community banks that are serving the agricultural community? How are they doing? Mr. Gruenberg, Hsu, or Barr.

Mr. GRUENBERG. I will say, Senator, as a general matter, community banks in the United States have been doing quite well over the last several years, and that is certainly true as well for community banks in the agricultural sector.

Senator TESTER. Have the rest of you seen in the same way? Mr. Hsu?

Mr. HSU. I am hearing that they are doing quite well. I think there are some concerns about some headwinds, which is part of the reason why we lowered bank assessments for OCC banks and we continue to engage with them. I think that some of the drought issues, for some of the banks in some parts of the country, luckily there has been crop insurance, but these are top-of-mind issues for the bankers and for supervisors.

Senator TESTER. Yeah. Last question, and I want this very quick. Mr. Hsu, you talked about geopolitical uncertainty as it applied to

the commodity space. What commodity are you talking about, or commodities are you talking about? Energy?

Mr. HSU. I think there have been some broad-based impacts across a number of different commodities markets. It depends on which time. At one point it was nickel, and that shifted over to some other commodities. So it is a broad range.

Senator TESTER. OK. Thank you. Thank you, Mr. Chairman.

Chairman BROWN. Senator Lummis, of Wyoming, is recognized.

Senator LUMMIS. Thank you, Mr. Chairman, and thank you all for attending today. Mr. Barr, I am going to have question for you in a minute about Regulation W.

But I too want to weigh in a little bit on the FTX situation. You know, it is awful, and simultaneously not all that surprising. Until June 2021, FTX was offering ordinary retail customers outside of the U.S. leverage of about 101 to 1. That leverage is illegal in the United States because it is extremely likely that a customer loses all their money, so no big surprise there.

FTX lent out customer assets for proprietary trading with its affiliate, Alameda Research, misusing its custody assets, which it did not own, and breaking its promises to its customers. So like Senator Toomey I agree. This is a lot like MF Global in 2011, and it should be absolutely forbidden.

My State of Wyoming saw this problem coming in 2019, and banned banks engaged in digital asset activities from relending customer digital assets. Now that may be surprising to some of the witnesses today, but Wyoming has a tough set of rules for digital assets, and I hope you will look at those at the Fed.

There were deep interconnections between FTX and Alameda that encouraged both to take big bets with customer assets that ultimately brought both down. Banks today are subject to limits on affiliate transactions under Regulation W and are required to disclose their affiliate relationships. These limits exist to prevent special transactions like those that occurred between Alameda and FTX.

So Senator Gillibrand and I incorporated many of those ideas into the Responsible Financial Innovation Act, and our act would have prevented the FTX bankruptcy by prohibiting misuse and lending of customer assets, requiring proof of reserves for digital asset exchanges, limiting affiliate transactions, and providing clarity for affiliate relationships, and clarifying the bankruptcy treatment of digital assets so customers get their assets back quickly if an exchange fails.

It is obviously that Congress needs to regulate digital assets, and the Lummis-Gillibrand bill is the legislation that most comprehensively addresses these issues in a way that balances consumer protection and responsible innovation. I am confident that we can get good legislation passed in 2023, and I look forward to working with my colleagues to do that.

Now Vice Chair Barr, I want to turn to you again, to talk about Regulation W. Why is it important that there be transparency on affiliate relationships for banking regulation and why should Congress consider that for digital asset exchanges?

Mr. BARR. Thank you, Senator. Regulation W is one of the foundation regulations for banking. It is really a quite important rule.

And it requires not only transparency but also substantive limits on the relationship between the bank and its affiliates. The basic idea is that we need to protect the insured depository from possibility of risks being transmitted from the affiliate to the insured depository and therefore hurting the customers and the depositors of the bank and potentially putting the deposit insurance system or taxpayers at risk.

So those kinds of limits on the kinds of transactions that banks can have with their affiliate are really a foundational part of banking law.

Senator LUMMIS. So applying that to, for example, the FTX situation, where there were over 130 related entities, would a Regulation W type of regulation have assisted in preventing or at least disclosing some of the concerns that developed with FTX?

Mr. BARR. Senator, I only have available the information you hear reported about in the press so I am not sure I am in a good position to opine on a particular case, a particular firm. I do not think that would be prudent. But I can say, in general, Regulation W is a really foundational principle and it has served the banking industry very well.

Senator LUMMIS. Thank you, Mr. Barr. Thank you, Mr. Chairman.

Chairman BROWN. Senator Warren, of Massachusetts. I apologize, Senator Kennedy. You are next after—I apologize. Thank you, Senator Kennedy. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

So since it was created by Congress just over 10 years ago, the Consumer Financial Protection Bureau, the CFPB, has forced financial institutions to return more than $13 billion directly to people they cheated. This is Government that works for the people, literally.

Now the banks do not like losing $13 billion. They do not like being forced to shut down scams. So they, and their Republican friends, attack the CFPB, and the latest attack has come out of the Republican's go-to court, the Fifth Circuit Court of Appeals. This court has ruled that the CFPB's funding structure is unconstitutional because it does not receive annual appropriations from Congress.

So I just want to test that out a little bit. All of you are here today from major regulators that oversee various pieces of the financial system—the OCC, the FDIC, the Federal Reserve, and the National Credit Union Administration. So let me start with you. Acting Comptroller Hsu, is the OCC funded from the annual appropriations process?

Mr. HSU. No.

Senator WARREN. Chairman Harper, does NCUA receive most of its funds from the annual appropriations process?

Mr. HARPER. No.

Senator WARREN. Acting Chairman Gruenberg, is the FDIC funded from the annual appropriations process?

Mr. GRUENBERG. No.

Senator WARREN. And Vice Chair Barr, is the Fed funded from the annual appropriations process?

Mr. BARR. No.

Senator WARREN. So, in fact, I want to focus just a little bit more on the Fed. Vice Chair Barr, the Fed primarily gets its funding from earnings and assessments from the Federal Reserve banks. Is that exactly the same source where the CFPB gets its funding?

Mr. BARR. Yes.

Senator WARREN. So look. There is a good reason why Congress created independent funding structures for bank regulators. Your agencies are the cops on the beat that ensure the safety and the stability of the banking system. Your rules provide the guidebooks for financial institutions to serve consumers while acting within the law.

Congress understood this even back in 1863, with the very first banking regulator, that if the ability of our regulators to do their jobs fluctuated every time Congress negotiated a spending bill or every time Congress changed hands, that the financial markets would be thrown into chaos.

Vice Chair Barr, your job is to make policy, not to worry about the Fed's budget. But let me ask, does the Fed's independent funding structure help provide certainty and stability to banks and financial markets because no one in the system has to worry about the Fed's ability to do its job or to have the resources to enforce the rules?

Mr. BARR. Yes, I believe that kind of certainty is quite important to doing our job effectively.

Senator WARREN. Well, unfortunately the Fifth Circuit's argument implies that because all of you are, and always have been, funded outside the annual appropriations process, that all of your agencies are unconstitutional. This would mean that none of you can do the things that you are doing, from setting interest rates at the Fed to making sure that when people make deposits in their banks that they are protected by FDIC insurance.

And it is not just your agencies. Numerous other Government entities are also funded outside the appropriations process, including the Federal Housing Finance Agency, the Farm Credit Administration, and the Financial Stability Oversight Council.

By the Fifth Circuit's logic, they would also be unconstitutional. Not only does that make no sense, it is also not what the Constitution says. The Constitutions says, and I will quote it here, "No money shall be drawn from the Treasury but in consequence of appropriations made by law," and no money is withdrawn from the Treasury to fund any of our financial regulators.

As Professor Noah Feldman notes, the Supreme Court has repeatedly and reasonably said that this clause, quote, "means simply that no money can be paid out of the Treasury unless it has been appropriated by an act of Congress." For this reason, the U.S. Court of Appeals for the D.C. Circuit and a slew of district courts have all upheld the CFPB's funding structure.

Even though this decision out of the Fifth Circuit is not grounded in law, it could have real consequences for the stability of our financial system. The Mortgage Bankers Association understands this risk. In 2019, they warned that if the CFPB were struck down, quote, "the results could be catastrophic for the real estate finance industry."

The Trump court ruling is not only shockingly dumb, it is also dangerous. That is what happens when courts play politics instead of following the law.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you, Senator Warren.

Senator Kennedy is recognized, from Louisiana.

Senator KENNEDY. Thank you, Mr. Chairman.

Welcome, gentlemen. I think Senator Warren pointed out that are major financial regulators, and we thank you for your time today. So let me ask you your opinion.

Would any single one of you hire Sam Bankman-Fried to manage a food truck? Would any of you?

Would any single one of you hire his girlfriend, Caroline Ellison, who apparently was trading billions of dollars, to manage a food truck?

Can you tell me who, in our Federal financial services regulatory administrative State, was watching FTX to make sure that no one there stole people's money?

Was anyone watching them, that you know of?

Mr. GRUENBERG. Senator, just from dealing with banking——

Senator KENNEDY. You are a brave man.

Mr. GRUENBERG. I understand. You are dealing here with banking and credit union regulators, and FTX was not engaged in the banking business or in credit union business.

Senator KENNEDY. No, I am not saying you should be. I am just asking, you guys are at the top of the food chain in terms of financial services regulation. Do you know who was watching these chuckleheads?

Mr. GRUENBERG. Well, these folks, I think, were engaging generally in investment and trading activity, and so in the first instance if you are thinking about——

Senator KENNEDY. It looks to me like some of them were engaged in stealing.

Mr. GRUENBERG. Well, that is under investigation now, Senator. So I think in the first instance you would probably want to engage with the market regulators, the SEC and the CFTC, to talk about the activities and the authorities in this area, candidly.

Senator KENNEDY. All right. I do not have a lot of time. I want to ask the chairman a few questions about inflation. Mr. Chairman, Professor Jason Furman—I think you know him—at Harvard, formerly of President Obama's administration, has said that he thinks unemployment has to rise by 5 percentage points for a whole year to bring inflation down a single percent. Do you agree with that?

Mr. BARR. Thank you, Senator. Let me just start by saying inflation right now is far too high. We——

Senator KENNEDY. Yes, sir, but I am going to run out of time. Doggone it. And our Chairman, he is fair but he is tough as a boot, and he is going to cut me off. Do you agree with Professor Fuhrman?

Mr. BARR. I think that it is the case that we are going to see significant softening in the economy. I do not have a projection that precise as Jason Furman to comment on.

Senator KENNEDY. All right. Let me ask you about Professor Larry Summers. He said that unemployment is going to have to

rise to 7.5 percent and stay there for 2 years to get inflation down 2 percent. Do you agree with that?

Mr. BARR. As I said, I think that we are going to see softening in the economy, but I do not have a prediction as precise as that one.

Senator KENNEDY. All right. You remember the inflation back in the 1980s, under President Reagan and President Carter, when Mr. Volcker was chairman. Can we agree that the only way we got control of inflation then was on both the fiscal and the monetary side?

Mr. BARR. Well, at the end of the day it is the responsibility of the Fed to ensure price stability consistent with maximum employment, so we are focused on our responsibility.

Senator KENNEDY. I know that. But if you depend on monetary policy alone, interest rates have to go higher. Let me put it another way. If Congress cooperated and stopped spending money like it was ditch water, the Fed would not have to raise rates as high. Is that a fair statement, to get control of inflation, of course?

Mr. BARR. I really will not have any comment on fiscal policy.

Senator KENNEDY. Do you think fiscal policy is irrelevant?

Mr. BARR. We take the fiscal policy that elected Members of Congress and the President enact, and we calculate those in our decisionmaking, but I do not have a comment on fiscal policy.

Senator KENNEDY. You do not have any comment on the contribution that fiscal policymakes to inflation.

Mr. BARR. I really do not have anything to add about that.

Senator KENNEDY. Well, add to what? You have not told me anything.

Mr. BARR. Add to what I said before.

Senator KENNEDY. You are not telling me that fiscal policy has nothing to do with inflation, are you?

Mr. BARR. I am telling you that at the Fed we take our monetary policy responsibilities as ours, and we leave to the elected——

Senator KENNEDY. Well, do you not think you have a moral obligation, if not a legal obligation, if you think fiscal policy is contributing to the inflation to say something, for God's sakes?

Mr. BARR. I think it is important for us to respect the role of the Congress and the President in setting fiscal policy and then to take that as a given in how——

Senator KENNEDY. Can you tell me, given the path we are on, how high unemployment is going to go in order to get inflation down?

Mr. BARR. I think we are going to see unemployment go up, but I do not have a precise answer to your question.

Senator KENNEDY. Duh. I think you are right. I do not mean to make light of you. Can you give me any prediction how high? I mean, Summers and Furman are saying it is going to have to go through the roof.

Mr. BARR. I have seen a wide range of predictions about that, and as I said——

Senator KENNEDY. What are those ranges?

Mr. BARR. ——we're going to be data dependent, we are going to see how the numbers come in, and unemployment is obviously an important factor we will look at.

Senator KENNEDY. Thank you for your indulgence.

Chairman BROWN. Thank you, Senator Kennedy.

Senator Van Hollen, of Maryland, is recognized.

Senator VAN HOLLEN. Thank you, Mr. Chairman. I thank all of you for your service and your testimony here today.

Vice Chair Barr, I want to start with you on FedNow. I have been a big proponent of moving to a real-time payment system. As you know, our current lack of real-time payments costs millions of Americans billions of dollars, especially those living paycheck to paycheck. In fact, Aaron Klein over at Brookings, did an estimate that said if the United States had implemented real-time payments when the Bank of England did, back in 2007, Americans would have saved over $100 billion in overdraft, check-cashing, and other fees. And those are mostly Americans living paycheck to paycheck.

So I understand from a speech you gave a little while ago you estimate that the FedNow program will be live in May to July of next year. Are we fully on track with that, because there have been lots of delays? Are we fully on track, and what share of Americans that bank do you think will then have access, at that point in time, to real-time payments?

Mr. BARR. Thank you, Senator Van Hollen, and thank you for the support of the FedNow program. I do think that FedNow is going to significantly improve the ability of banks to offer real-time services to customers. FedNow obviously will sit as the backbone behind what community banks and others decide to offer. That will take some time to flow through the system. We are on track to do that launch in the May to July period, but it will take time to build the number of institutions that are well positioned to offer the kinds of services that FedNow will then allow them to do. So ramp-up time is going to take a while.

Senator VAN HOLLEN. All right. Well, we look forward to a very concerted campaign by the Fed to make sure that banks are aware of their ability to sign up, and help them sign up.

As you all know, there is a lot of volatility in the global economy these days. The Dodd-Frank legislation authorizes FSOC to designate a financial market utility as a systemically important financial institution, the SIFI.

Back in May, Secretary Yellen expressed concerns about some of the guidance issued under former Treasury Secretary Mnuchin that she believed unnecessarily limited FSOC's authority in this area. Do you have concerns about the 2019 guidance that was issued under the Trump administration, and do you believe that this should be revisited?

Let me put it more bluntly. If Secretary Yellen asked to repeal the 2019 guidance, would you support that as members of the FSOC?

Maybe start with——

Mr. HSU. Yes.

Mr. GRUENBERG. Senator, yes, I would be supportive.

Mr. HARPER. Yes.

Mr. BARR. Yes. I think it would be useful to revisit the guidance and to make sure that it is working. Again, we are evolving with circumstances. We are taking the risks that might come in the sys-

tem in the future into account, and it would be useful to do it for that reason.

Senator VAN HOLLEN. I appreciate that because I share your concerns about that guidance.

Now much has been said about cyber currencies and the collapse of FTX, and a lot have called for regulation. I have been a proponent of some regulation in this area. But there are those who make the case that regulation would actually normalize an area where there is inherent risk and create potentially the false impression that investment in these areas is safer than warranted.

So there is a threshold question about regulation here. I would be interested very quickly in each of your ideas. Regulate, and that can be any form of regulation, or not regulate because that creates an impression that things may be safer than others by giving the Federal Government imprimatur?

Mr. HSU. Thank you for the question. So first and foremost, I have responsibility for the safety and soundness of the national banking system, so I am always going to put that first.

The devil is in the details, so a lot depends on the details of that regulation. I think there is a form of it which could perform its intended objective. I think there are going to be potentially forums that do not, and that fall into the trap that you just laid out. So I think a lot really depends on what those details are.

Senator VAN HOLLEN. Thank you.

Mr. GRUENBERG. Senator, I think in one way or another regulation is going to have to be necessary for the activity. I think it is important to consider carefully how we approach that. Talking about the crypto activity, almost all of it now is really investment and trading activity. So in the first instance it seems to me it falls to the market regulators, the SEC and the CFTC.

There is some interest, limited interest, in the banking sector, and to the extent there is interest among banks that will fall to us. As a general matter, I think we have authorities now to deal with the safety and soundness and consumer protection risks of bank engagement with crypto activities.

I do think that the stablecoin issue is a bit more complicated, and we do have existing authorities in that scenario, there there may be a case for considering legislation. But I think more thought needs to be given there.

Senator VAN HOLLEN. Thank you.

Mr. HARPER. I will agree that regulation is needed in this area. Sort of building on what the acting comptroller said, the devil is in the details, and an important detail for me would be transparency. Having lived through the financial crisis of 2008, it really impressed upon me the need for better transparency in our financial markets.

Senator VAN HOLLEN. Thank you.

Mr. BARR. I would similarly suggest that the market regulators are the sort of first place to start in this space. They have existing authorities. We want to make sure those are fully utilized. Some of the activity, that was going on in this space was purporting to go on in a way that was designed to evade supervision and regulation. I think we have seen the enormous human costs of that kind

of activity that investors and consumers who were so badly hurt by the recent events in the crypto space.

In the banking sphere, just to reiterate what Director Gruenberg said, we do have the authorities we need in the banking space to get the job done in banking.

And last, I do think there is quite an important need for developing a prudential framework for stablecoins with strong Federal approval and supervision and regulation and enforcement.

Senator VAN HOLLEN. Thank you. Thank you all.

Chairman BROWN. Thank you. Senator Hagerty, of Tennessee, is recognized.

Senator HAGERTY. Thank you, Chairman Brown, Ranking Member Toomey, and thanks to all of our panelists for being here today.

I want to follow up on the line of questions that my colleagues have brought up, particularly around the astonishing set of events that led to the collapse of FTX last week. I think a number of people are calling for this incident to be a rationale or a reason to call cryptocurrency regime nothing but a Ponzi scheme, that we should regulate it very swiftly, put heavy-handed regulations in place to deal with it. Several of you seem to agree that regulation is appropriate.

But I want to acknowledge that some of the blame for this catastrophe has got to be place on lawmakers here in the United States, and it should not go unaddressed. The fact of the matter is that crypto, much like all of finance, is not beholden to a specific country or a specific legal system. And by not acting and by failing to provide legal clarity here in the United States, Congress only incentivizes activity to migrate outside of our country's borders.

Further, it is important to recognize that whatever happened with a bad actor running a centralized exchange and defrauding customers, that had nothing to do with the technology underpinning crypto itself.

We should not take the wrong message from what happened last week. No amount of poorly considered, knee-jerk over-regulation here in the U.S. would have prevented a foreign-domiciled company like FTX from doing what it did. Instead, we should focus on accelerated but thoughtful efforts to provide clear incentives for companies to domicile here, under laws that would prevent the billions of dollars of losses like those just incurred by FTX's unsuspecting customers.

So Acting Comptroller Hsu, I would like to come to you. Last month you said, in a speech, that you were also concerned about the lack of clarity in crypto regulation here in the United States. Do you agree that with a clearer regulatory construction in America more cryptocurrency companies would be encouraged to operate here rather than offshore, where regulatory frameworks are obviously inadequate to prevent large-scale fraud?

Mr. HSU. It could. I am more concerned, though, there are some basic foundational elements of the cryptocurrency technology and the industry which are not sound currently. And so regardless of the regulation, there are some issues with, for instance, ownership is not clear. And so if you do not have clarity about what you own then, you know, a market where property rights are unclear is a market built on sand. Those issues are outside of any kind of regu-

latory discussion. The state of the crypto industry is not mature, and I think that is a factor that has to be taken into account as we kind of work through what to do next.

Senator HAGERTY. Yeah. From my view, the maturity of our markets, though, and our regulatory system is much stronger than some of the markets where these companies are domiciled right now, and our view, if I understand all of you sharing a view that regulation is appropriate, is that the appropriate level of regulation that would give clarity and would help us deal with this would be more appropriate happening here onshore than again pushing this overseas.

Mr. HSU. Well, at least speaking as a bank regulator, to the extent that the activity takes place in the national banking system, it has to be safe, sound, and fair. People need to understand that. We need to make sure that we maintain that level, that standard for the activity.

Senator HAGERTY. I agree, and I look forward to continuing working with you toward that end.

Vice Chairman Barr, can I turn to you for a moment please? The Fed's own stress test results and financial stability reports recognize the strength of the U.S. banking system, not to mention the fact that our banks just supported our economic through the pandemic. And yet it seems that you are planning to layer yet more costly reforms on our banking system just as the U.S. navigates a recession and as the Fed fights the highest inflation that we have seen in generations.

Part of this plan appears to be by raising capital requirements on midsized banks with a heightened leverage requirement. Under current market conditions, these requirements seem inconsistent with S. 2155 and the statutory mandate for capital requirements to be countercyclical.

So my question for you, Vice Chairman Barr, why is the Fed reversing course now and considering punitive new leverage and capital requirements for regional banks that could impede their ability to support the economy? Would you not agree that raising capital requirements now is not countercyclical?

Mr. BARR. Thank you, Senator. We are undertaking a holistic review of capital requirements for firms. That includes issues about the globally systemically important bank surcharge, the countercyclical capital buffer, the enhanced supplementary leverage ratio, stress testing, and the like, to make sure that the capital rules are fitting well together.

We are not trying to design a capital system for tomorrow morning. We are trying to think about what the capital rules should be over the cycle. So that involves, if we change the rules, undergoing a proposal and then a final rule and then an implementation period.

Senator HAGERTY. Just for clarity—I am running out of time—I just want to ask this and make it clear. Would increasing capital requirements right now, in the environment that we are in, amidst a recession, be procyclical or countercyclical?

Mr. BARR. Well, Senator, in technical terms there is not a recession right now. We are in a slower period of economic growth.

Senator HAGERTY. If you ask the people of Tennessee I can tell you we are in very tough times.

Mr. BARR. Very tough times. I agree.

Senator HAGERTY. Is this the time to be following the rule of law and have our requirements be countercyclical, or do you want to accelerate the process and push us further into recession?

Mr. BARR. As I said, I think it is important that we have capital rules that are good for the whole cycle, and that is the approach that I am trying to take.

Senator HAGERTY. Well, I certainly hope that you will take strong note of the fact that I am concerned about any move that might be procyclical in the situation that we are heading into a recession, which I believe we are. Thank you.

Thank you, Mr. Chairman.

Chairman BROWN. Thank you. Senator Smith, from Minnesota, is recognized from her office.

Senator SMITH. Thank you, Mr. Chair, and thanks to all of our panelists for being with us today.

I would like to start out by asking a question about climate. So climate change can cause severe economic disruptions and risks to our economy. We see this in Minnesota and the impacts on agriculture and tourism and forestry, and lord knows we have seen it in Florida and places like Florida over this last fall. And our financial system is not immune from this risk and disruption.

So banks recognize this climate risk and are taking steps to manage it, and given the severity and the scope of the threats that we face, many of us think that we do need clear guidance from regulators on how to approach this problem.

So I want to direct this first to Mr. Gruenberg and Mr. Hsu. Your agencies took a step forward by issuing draft principles to help larger banks manage climate-related risks. I realize that you received, as I understand it, thousands of comments in response. But I wonder if each of you could briefly tell us what is the general reception that you have gotten so far.

Mr. GRUENBERG. I think, Senator, if I may, I think the industry is receptive to guidance from the agencies in regard to managing the financial risks of climate change. I think the actions taken by the OCC and the FDIC were really an initial effort on our part to lay out a basic framework to incorporate the financial risks of climate change into the risk management framework that our institutions are familiar with. We have been engaging with the Federal Reserve as well.

So I think it is our intention, and we believe this is important, for the three agencies to act together so that the guidance is consistent across the banking system, and this would be a first step to offer guidance. As you know, the focus of this initial guidance is on institutions with assets over $100 billion.

Senator SMITH. Thank you. Mr. Hsu, could you respond as well, and maybe let us know a bit about when you anticipate next steps?

Mr. HSU. Sure. So just to echo what Acting Chairman Gruenberg said, I think for the larger banks this has been generally welcomed, and it has been welcomed because especially those who are internationally active, they have been having to deal with some of this from abroad, which is how do we identify, measure, monitor, and

manage risks from climate change? So I do not think that is a new thing.

I think for smaller banks there has been a bit more of a kind of variation in responses, and this is something that I have been focused on, is trying to engage with community banks as to what the issues are and listening, making sure that we understand where they are coming from, what their concerns are with all of this.

One pitch I try to make is not only are there risks to manage, there are opportunities. And there is a saying, the better a car's brakes, the faster you can safely drive the car. And I think that applies in spades here to climate risk, where some of these risks are novel, they are new, and if banks can get good at managing those it also presents some opportunities for them.

In terms of your timing question, just to echo something that Marty said, we are working together and we are trying to prioritize making sure that the three agencies work together on that. That is taking a little bit of time, but I am pretty sure we will get there in the not-too-distant future.

Senator SMITH. Thank you so much. Mr. Barr, you have spoken about your intention to work with FDIC and OCC on guidance in this area. Would you care to comment on this and sort of how you see this working in conjunction with the scenario analysis exercise that the Fed is going to be doing next year?

Mr. BARR. Thank you, Senator. Yes, we intend to join with the FDIC and the OCC in issuing climate guidance with respect to firms that are over $100 billion in assets, the largest firms in the country. I think it will be helpful to them to have that guidance. So we expect to join the other agencies in doing that.

And then as you noted, we are also engaged with a pilot of climate scenario analysis that we are conducting with six of the globally systemically important banks. That will be conducted next year, and we expect to learn a lot from that exercise about how firms are managing the financial risks of climate change and how they are assessing those risks. So an important learning exercise for us in the coming year.

Senator SMITH. That is great. Thank you. I appreciate very much all of your agencies working together on this. I think having clear input from banks of all the different sizes, from community banks to the large, systemically important banks is extremely important. And it sounds like what you are finding so far is highlighting what we already know, that banks appreciate this risk, that they want some good, clear rules of the road for how to work with it and how to manage it. So I am grateful for all of your work on this.

Mr. Chair, I have another question on bank consolidation but I will pursue that with a question for the record. Thank you.

Chairman BROWN. Thank you, Senator Smith.

Senator Moran, from Kansas, is recognized.

Senator MORAN. Mr. Chairman, thank you. Thank you all for being here.

Mr. Gruenberg, let me begin with you. I am going to express, in a polite way, my dissatisfaction with the demise of the Office of Supervisory Appeals. Despite a multiyear effort by the FDIC to establish, fund, staff, and operationalize the newly minted Office of Supervisory Appeals, which included a robust public comment proc-

ess, you chose to dismantle this more independent supervisory appeal process just months after it became fully operational, and it was one of your first actions as acting chair.

Moreover, you did so through a summary agenda vote, without any substantive discussion or prior public notice, providing only a 30-day comment period after the effective date of its demise.

How do you justify such an arbitrary was of FDIC resources with a total disregard for process and transparency?

Mr. GRUENBERG. Thank you, Senator. This is an important issue, as you indicate. A law was passed in 1994, requiring all of our agencies to establish internal appeals processes, to consider appeals by our regulated institutions of supervisory determinations. And shortly after the enactment of that law, the FDIC established a board-level committee, a Supervisory Appeals Review Committee, to consider appeals.

It was a determination that at the end of the day the appeals process is very important. Any bank that believes that an examiner has made an inappropriate decision or a wrong decision should have the right to have that decision reviewed by an appropriate process. And I think the view of the FDIC, from the time the requirement was established, was that a board-level review, which is the highest authority within the agency, is an important matter for board accountability. At the end of the day, the board is responsible for the decisions of our supervisors. If there are issues raised in regard to a supervisory determination, that ultimately should rise to the level of a board review.

You accurately indicate that a change was made and an Office of Supervisory Appeals was adopted, utilizing individuals from outside of the FDIC and did not necessarily have experience working at the FDIC. But they had supervisory experience of some kind, to sit in judgment of these supervisory determinations.

I think our view was that board-level accountability was, frankly, very important in this area, and the Office of Supervisory Appeals had not yet begun functioning. The Supervisory Appeals Review Committee, the board-level committee, had a longstanding history and experience, so we did set aside the Office of Supervisory Appeals and continued the operation of the board-level committee, and then sought comment.

We received quite a bit of thoughtful comment, and we have now issued a new request for comment, incorporating into the proposal some of the suggestions we received in the comments, including placing our ombudsman, who is a neutral part, a nonvoting member of the board-level committee, giving appealing institutions the right to get access to all of the memos and documents relating to the supervisory determination that they are appealing, and also the right to request a stay of the supervisory determination until the appeals process is completed.

So it may not be fully satisfactory, but we have tried to take a balanced approach to this, Senator.

Senator MORAN. And do you place any importance upon—you used the word "neutral." I would use the word "independent." But whatever that is, is there a value to having somebody independent or neutral, compared to the board?

Mr. GRUENBERG. I think so, and that is why we added the ombudsman to the appeals committee, Senator.

Senator MORAN. Thank you for your answer.

My second question is really to the panel. The Federal Housing Finance Agency's tangible capital rules is inconsistent with the Federal prudential regulators' capital rules for accessing advances from the Federal home loan bank system. As this interest rate environment continues to escalate with more unrealized losses on typically high-quality treasures and mortgage-backed securities expected, we will likely see an increasing number of, quote, "well-capitalized institutions" lose access to key sources of liquidity due to this disparity in the regulatory framework.

Although FHFA is well aware of the issue, the default has been for affected Federal home loan bank members to seek waivers in writing from their prudential regulators instead of what I would assume would be a far easier fix aligning those capital rules.

Do you have thought about the desire of aligning those capital rules, is the first question, and in the absence of that, what is the process for member institutions seeking a waiver from each of your agencies?

Mr. Gruenberg.

Mr. GRUENBERG. Thank you, Senator. It is an important issue, and this is an FHFA rule that we are dealing with. FHFA has a requirement that if a bank has negative tangible equity, under GAAP accounting, the bank is not allowed access to new Federal Home Loan Bank loans. It can roll over existing loans but it does not have access to new loans until it addresses its negative tangible equity position.

Senator MORAN. That is a different standard or rule than any of the agencies sitting at the table.

Mr. GRUENBERG. The banks have regulatory capital in addition, and that regulatory capital does not count in the unrealized losses that result under—and this gets pretty technical, as you know—under GAAP accounting, puts it into a negative tangible equity position. But it is an underlying risk management issue for the institution if it has negative tangible equity under GAAP.

So we are engaging with FHFA and the banking institutions. As a threshold, we are looking at the banks, addressing their risk management issue resulting from the unrealized losses on their balance sheet, and we will see if we can work this through.

Senator MORAN. Thank you. Are you suggesting you do not expect it to be a problem then for those banks to access Federal home loan?

Mr. GRUENBERG. I am speaking for myself. I think we are looking for the institutions to address the underlying issue, which is the unrealized losses and their negative capital position under GAAP, in order to gain access to Federal Home Loan Bank loans.

Senator MORAN. Let me then ask the question about——

Chairman BROWN. Last question, Senator Moran. You are way over, but go ahead.

Senator MORAN. I have sat here from the beginning, Mr. Chairman——

Chairman BROWN. I know you have.

Senator MORAN. ——with you and the Ranking Member.

Chairman BROWN. There is a reward for that.

Senator MORAN. Thank you, plus our longstanding friendship.

Is there a process by which a waiver is obtainable from the prudential regulators, as the Federal home loan bank system suggests—I did not say that right—as FHFA suggests?

Mr. HSU. So for us it is basically using the regular way supervisory process is the way to address that.

Just to echo a point that Marty made, we also see this as fundamentally a risk management issue, and the alignment question is really a question for FHFA to address.

Mr. HARPER. And if I could, just on a couple of things, first of all like the OCC we would look at it through the supervision process overall. I think it is important to remember, though, that when liquidity is provided by a Federal home loan bank there are assets pledged as collateral for that, and there is a super-lien that attaches to that. So we, as an insurer of the deposits at our credit unions, would be placed, potentially, depending on what the asset was pledged, we could have a higher liquidation cost if the institution were to ultimately fail.

I think that is even more important why Congress needs to move ahead with the agent-member relationship that we currently do with the corporate credit unions through the central liquidity facility. It is a Federal liquidity backstop, and that is another way to deal with this issue.

Chairman BROWN. Thank you. Thank you, Senator Moran.

Senator Ossoff, I believe, is the last questioner, from his office, from Georgia.

Senator OSSOFF. Thank you, Mr. Chairman, and thank you to our panelists for your service.

Mr. Barr, first question for you, please. What do you assess to be the most significant threats to financial stability today?

Mr. BARR. Thank you, Senator. We are looking broadly across the financial sector to look at risks. I mentioned earlier in our hearing we are looking at, in part, the risks that we do not fully understand, risks in the nonbank financial sector. We are certainly exploring and analyzing the risk that has been going on in the crypto sector.

We are, as always, attentive to risks abroad, from the war in Ukraine, the situation in China, and looking at what is happening in interest rate risk and liquidity risk in the system as interest rates rise.

And then as the economy is softening we are attentive to credit risk, particularly with respect to commercial real estate and residential housing, which tend to be leading indicators of potential problems in other areas.

So those are the kinds of risks we are looking at.

Senator OSSOFF. Thank you, Mr. Barr. How confident are you that Federal regulators have adequate visibility into potential exposure in the nontraditional financial institutions to risks that could pose a threat systemically to financial stability, and where are the blind spots?

Mr. BARR. We have good insight into the regulated banking system. We have very good, sound information not only about the

banking system but about the relationship of banks to other entities.

Where we do not have as good of information is what is going on in the nonbank sector. We have increased information, more than we did a decade ago, about what is happening in hedge funds, so that is an advance, but still more information would be useful in that space.

We have very little visibility into institutions that are not directly connected to banks, so very little information, for example, about the risks of the kind that we saw recently in the crypto sector, where our visibility is much, much lower.

Senator OSSOFF. Secretary Yellen, Mr. Barr, stated last month she was, quote, "worried about a loss of adequate liquidity in the Treasury market." I have also queried the Fed chair about this. Do you share her concerns, and can you characterize them, please?

Mr. BARR. Thank you. I do think that we are seeing higher volatility in Treasury markets and in many other markets that are associated with the period of rising interest rates and economic uncertainty, both in the United States and globally. And with that increased volatility has come a reduction in liquidity of the type that you would expect given the volatility in the market.

So, you know, we are watching it very closely, as always, and it is something we are attentive to in thinking about the risks that lie ahead.

Senator OSSOFF. I appreciate that, attentive to it. Are you worried about it? Secretary Yellen said she was "worried about a loss of adequate liquidity in the Treasury market." Others have characterized this as a potential threat to financial stability. Do you have a different view, sir?

Mr. BARR. Well, I would say, as always, we are attentive to issues that might arise throughout the financial sector, including in Treasury markets. I think it is appropriate to be attentive to it, and we are attentive to it.

Senator OSSOFF. Thank you.

Mr. Gruenberg, I would like to ask you the same question, please. What do you assess to be the most significant threats to financial stability?

Mr. GRUENBERG. I generally concur to the observations that Michael made. I do think the rising interest rate environment, and important to recognize that it is a global phenomenon, that it is not just the U.S. as a jurisdiction that sees rising rates but other major jurisdictions as well. And so both from a national and international perspective the potential financial stability risk is there.

Senator OSSOFF. Yeah. Mr. Gruenberg, forgive me. My time is running out. I want to just frame this question as precisely as I can. Of course, there are threats to growth, and I am really focused here on threats to financial stability. I think the most constructive follow-up I can ask you is, what do you think are the mechanisms of action or the forms of exposure that will translate higher rates, potentially, into destabilizing financial shocks? That will be my last question.

Mr. GRUENBERG. Yeah. I think the other point that Michael made that I would concur with, and you raised it as well, I believe, Senator, is the nonbank financial sector and the potential leverage

in that sector and the risks that can pose, both for the risks of those institutions as well as their connectedness to the banking system——

Senator OSSOFF. Who are the counterparties for that leverage?

Mr. GRUENBERG. Well, and the counterparties may be banks. And we do not have as good of a line of sight into the inner workings of the nonbank financial firms as we do with the banking institutions. And so it is both the risk we know and the risk we do not know, and that, I think, really needs to be the focus of attention.

Senator OSSOFF. Thank you. I thank you for your testimony and I yield back, Mr. Chairman.

Chairman BROWN. Thank you, Senator Ossoff.

Throughout today's testimony we have heard over and over how these regulators, the four of you, are protecting Main Street, watching out for risks facing our Nation, no matter how small or large. We have heard a lot of concern about crypto risks today, a reversal from Trump regulators who let crypto run wild, as you all recognize. My Democratic colleagues and I warned of the risks to consumers and investors, have been for months and months and months, years in some cases. I am confident our witnesses today will continue to watch out for those risks, to protect people and communities, not to protect Wall Street, like we have seen in past years.

I thank the four of you for being here, for providing testimony. For Senators who wish to submit questions for the record they are due 1 week from today, Tuesday, the 22nd of November. To the witnesses, you have 45 days from receipt to respond to those questions.

Thank you again. The hearing is adjourned.

[Whereupon, at 12:13 p.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF CHAIRMAN SHERROD BROWN

We know that most Americans want the same things—a safe, affordable place to call home, a good-paying job, and a strong, stable Government that they can trust. Our democratic institutions are only as strong as the people who empower them. Our economy works best when we have a free and fair democracy in which everyone can live their lives with dignity.

For too long, many of these dreams have felt out of reach. Working families struggle to pay for groceries, to keep gas in their car and a roof over their heads. We know the cost of living and raising kids continues to rise.

Democrats are listening and have delivered for the American people. We passed legislation to lower prescription drug costs. We helped families stay in their homes during the height of the pandemic. We made investments in public transit and our Nation's infrastructure. For the first time in generations we've been focused on communities that our Government has turned their back on, especially the State government in my State. Now we are tackling inflation by taking on corporate power and consolidation and by reducing our dependence on foreign oil.

We're doing all that while creating good-paying manufacturing jobs here at home. These jobs, making semiconductors, electric vehicles, and solar panels, are the jobs of the future. Those jobs will go to Americans because we passed the CHIPS Act, the Inflation Reduction Act, and the Bipartisan Infrastructure Law.

And we're seeing results. Our economic recovery has been strong and continues to grow. Over the past 2 years, many Americans have built up more in savings. We've seen robust job growth and, for the first time in decades, wage gains for workers. And just last week we began to see signs that inflation is starting to cool. Banks and credit unions are doing well, thanks to the protections we put in place in the Dodd-Frank Act and because of the support Congress and regulators provided during the pandemic.

But too many big corporations have taken advantage of market concentration, jacking up consumer prices and earning higher and higher profits. As my colleague Senator Reed has pointed out, the biggest banks that benefit from higher interest rates today are not passing on those benefits to their customers, penalizing Americans who are trying to build up their savings.

Workers and small businesses who are already struggling under the weight of inflation shouldn't get hit with exorbitant bank fees, lose their money to a crypto scam, or worry that their savings will disappear overnight if a mismanaged bank or credit union fails. And none of us want a scenario where risky bets on Wall Street crash the economy again.

That's why it's so important that we have financial watchdogs who are empowered to look out for Main Street, helping more Americans hold on to their hard-earned money at a time when they need it most.

The banking and credit union regulators are independent agencies that protect consumers and make sure banks and credit unions are safe and strong. Their independence matters. It makes for a more stable financial system and that's essential for our entire economy.

Our witnesses today all have decades of banking and credit union regulatory experience. They have spent their careers serving the public and protecting consumers, making sure our banking and credit union system works for Main Street, not just for Wall Street.

That is exactly what they continue to do today.

They are modernizing and strengthening an important civil rights law that will spur new investment in neighborhoods and communities that have been left on their own.

They've taken a closer look at overdraft, nonsufficient funds, and other "gotcha" fees at banks and credit unions to make sure that consumers are treated fairly, and that these fee programs don't raise safety and soundness concerns.

They are taking a fresh look at the bank merger approval process, so we don't just rubber stamp consolidation when it can have big consequences for local economies—too often big banks merge and close branches, leaving rural towns and urban communities without a bank.

They are revisiting the financial safeguards that protect us from risks at big foreign banks. They are making sure bank failures don't leave taxpayers holding the bag. It's important to remember the superregional banks of today are hundreds of billions of dollars bigger than the largest banks that failed during the financial crisis. Our financial regulators know that we need strong capital requirements so that banks and credit unions can continue to lend to and invest in their communities, in good times and bad.

They are also overseeing the formation of new institutions that serve communities that often get left behind. Just last week, the NCUA chartered a new faith-based credit union, and the FDIC recently approved the first mutual bank in 50 years, which will pave the way for more, in Ohio and across the country. All the agencies are working together to foster new banks and credit unions, and support the work of MDIs and CDFIs in their communities.

At the same time, our regulators are looking out for risks on the horizon—the effects of climate change, the rise in crypto assets, the risks from shadow banks, and the constant threat of cyberattacks. They're working with the banking and credit union industry to prepare for climate-related risks and bolster cybersecurity protections as criminals become more sophisticated and geopolitical threats increase. They've stepped up to protect depositors and consumers when crypto firms mislead them into thinking their money is safe . . . when it isn't.

But we must stay vigilant and empower regulators with the tools to combat these growing risks. Data breaches at banks and credit unions happen too often, threatening customer data and exposing our financial system to vulnerability. That's why we need to pass the bipartisan Improving Cybersecurity of Credit Unions Act led by Senators Ossoff, Lummis, and Warner.

We need to make sure that banks and credit unions can partner with third parties in a way that allows banks to stay competitive without putting consumer money at risk.

And we can't let big tech companies and risky shadow banks play by different rules because of special loopholes.

All these things will help strengthen our banking and credit union system for its core mission: serving Main Street and workers and families. When workers have more power in the economy, they find better paying jobs and we have a stronger labor market. That helps credit unions, which added over 5 million new members over the past year, and drives down the number of households without a bank account, which dropped to record lows in 2021.

When Government is on the side of working families—more Americans save money, build wealth, start small businesses, and participate in our economy.

Our financial regulators have answered that call, and I will continue to work with them to make sure our banking and credit union system works for everyone.

Before I conclude my remarks, I want to thank all our witnesses for being here today. I also want to congratulate Marty Gruenberg on being nominated by President Biden to be Chair of the FDIC. Marty is a well-respected and seasoned regulator who has worked to protect consumers and preserve confidence in our banking system. As many of you know, Marty played an instrumental role in helping implement many of the Dodd-Frank reforms needed to enhance financial stability and manage risks to our banking system. With Marty's experienced leadership, I have no doubt that FDIC can continue to address risks to our financial system, increase access to affordable financial services, and ensure that banks honor their commitment to communities across the country through the Community Reinvestment Act.

This Committee looks forward to holding a nominations hearing in the next few weeks for Marty and the other FDIC nominees.

PREPARED STATEMENT OF SENATOR PATRICK J. TOOMEY

Today, we'll hear from our banking regulators about their recent regulatory activities.

Throughout this Congress, I have warned about the politicization of financial regulation.

Some bank regulators are increasingly straying outside their mandates into politically contentious issues.

Take global warming: In September, the Fed announced a "pilot climate scenario analysis exercise" with six of the largest U.S. banks.

Now, we're told this is merely an exercise in ensuring that banks understand their risks.

But the data—including the Fed's own research—show that there's no physical risk to banks from severe weather events.

The only other risk is so-called "transition risk."

But we know banks are fully capable of pricing risks into their business decisions, including risks from changing customer preferences over time.

The real risk here is political.

My worry is that an attempt to somehow quantify political risk will eventually result in regulations designed to allocate capital away from carbon-intensive companies.

It appears some bank regulators are already committed to doing just that.

For example, the Fed, FDIC, and OCC have all joined the "Network for the Greening the Financial System," an international group of financial regulators with a stated aim to "mobilize mainstream finance to support the transition toward a sustainable economy."

In other words, its goal is to allocate capital away from carbon-emitting industries to those deemed to be sufficiently green.

And let me emphasize: the Fed, FDIC, and OCC have all joined this group.

The NCUA has also warned that credit unions "may need to consider adjustments to their fields of memberships as well as the types of loan products they offer" because of global warming.

Here is the reality: some unelected financial regulators want to accelerate the transition to a lower-carbon economy by misusing their powers to allocate capital away from traditional energy companies.

But addressing global warming requires difficult political decisions involving tradeoffs. In a democratic society, these tradeoffs must be made by elected representatives accountable to the American people through a transparent and deliberative legislative process.

I supported Vice Chair Barr's nomination, despite our policy differences, based, in part, on his commitment to stick to the Fed's narrow mandates.

At his confirmation hearing, Vice Chair Barr stressed that the Fed "should not be in the business of telling financial institutions to lend to a particular sector or not to lend to a particular sector.

I urge him to keep that commitment by pulling the Fed out of the politically contentious issue of global warming.

Federal banking regulators have also been preoccupied with establishing new rules, the need for which are, in some cases, dubious.

For example, last month the Fed and FDIC proposed potential new requirements concerning the resolvability of regional banks. This proposal is predicated on the assumption that the only realistic option to resolve a large regional bank would be to sell it to an even larger bank.

It's not at all clear that this assumption is warranted, or that new requirements are appropriate for regional banks, for at least two reasons.

First, the Fed and FDIC have approved regional bank resolution plans for nearly a decade. And nowhere do these plans contemplate wholesale acquisition by larger banks.

Second, large regional banks have more than doubled their most loss-absorbing capital since the financial crisis. This dramatically improves their resilience and decreases the likelihood they'd need to be resolved.

Some regulators seem to hold the misguided view that the benefits of new requirements always outweigh the costs.

But we know regulation isn't without cost.

As regulation increases, financial activities will continue to migrate out of the banking system.

While some of our banking regulators have been distracted, they've failed to address real challenges facing the financial system.

For example, last year the Fed, FDIC, and OCC committed to providing greater clarity on the involvement of banks in crypto activities, such as providing custody services and issuing stablecoins.

Over a year later, they've provided no public clarity.

During that same period, we've seen several high-profile collapses of crypto companies, including one prominent example last week.

It's very possible that customers harmed by these collapses would've been better off if their crypto assets had been safeguarded by regulated banks that have been providing custody services for hundreds of years.

But many banks have been pressured—by you—not to provide crypto-related services until your agencies provide clarity, leaving them in a state of limbo. I will, however, note that Chairman Harper has not pursued this pressure campaign with credit unions. In fact, he has issued guidance for credit unions on partnering with crypto companies, or using distributed ledger technologies.

However, the ambivalence of the remaining agencies has helped to push crypto activities into foreign jurisdictions with weaker or no regulatory regimes. As a general matter, the failure of Congress to pass legislation in this space and the failure of regulators to provide clear guidance has created ambiguity that has driven developers and entrepreneurs overseas. And we've just once again seen how that ends.

There is one other item I'd like to highlight before we start: the deteriorating liquidity in the market for U.S. Treasuries.

In March 2021, the Fed committed to modify the supplementary leverage ratio—or SLR—in part to allow bank dealers to intermediate in this market. Yet, over 18 months later, the Fed has failed to act.

I understand that Vice Chair Barr has only been in his role for 4 months and has reasonably suggested that potential amendments to the SLR should be considered in the context of other capital requirements. But we should recognize that a significant decline in Treasury market liquidity is already occurring.

Absent an improvement, I fear that Fed might one day intervene by restarting its bond purchases, which would undermine its objective of fighting inflation.

What I hope to hear from our banking regulators today is that they'll: prioritize these and other real challenges and not stray beyond their mandates into politically contentious issues or establish unnecessary new regulatory burdens.

PREPARED STATEMENT OF MICHAEL S. BARR

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

NOVEMBER 15, 2022

Chairman Brown, Ranking Member Toomey, and other Members of the Committee, thank you for the opportunity to testify today on the Federal Reserve's supervisory and regulatory activities.

Earlier this year, I was honored to be sworn in as the Board's Vice Chair for Supervision. In this role, my priority is to make the banking system safer and fairer. That requires active and careful analysis of risks. The banking system is constantly evolving, so regulation and supervision must also adjust to respond to new and emerging risks. I am also committed to making the financial system fairer, which is fundamental to financial oversight. Households and businesses need access to safe and reliable banking services as they make their financial decisions. While safety and fairness may seem distinct, they are interwoven. Financial instability disproportionately harms those who are economically vulnerable, so making the financial system safer is making it fairer, and unfair practices can make the financial system riskier, as we saw in the Global Financial Crisis. I look forward to pursuing both of these goals during my time as Vice Chair for Supervision.

Accompanying my testimony today is the Federal Reserve's Supervision and Regulation Report detailing the current state of the banking system from our supervisory and regulatory perspective. My testimony will offer you an overview of the banking system's current conditions and highlight efforts to monitor and mitigate vulnerabilities. I will also provide updates on a number of priority issues that the Federal Reserve is seeking to address.

Current Conditions

Reforms following the Global Financial Crisis have helped the United States maintain a resilient financial system for consumers, businesses, and communities. Capital and liquidity positions remain above regulatory requirements. The Federal Reserve's supervisory stress test, conducted earlier this year, showed that large banks had sufficient capital to maintain their lending to support the economy through the stressful conditions simulated by the stress test.

But as I mentioned, we must ensure we are keeping pace. Many issues at the forefront of banking regulation today were not prominent five or 10 years ago, and some of them scarcely even existed. For instance, few anticipated a global pandemic, even economists who used epidemiological approaches to model financial contagion. Further, the recent events in crypto markets, while mostly occurring outside the banking sector, have highlighted the risks to investors and consumers associated with new and novel asset classes and activities when not accompanied by strong guardrails.

In addition, despite the data depicting a generally healthy U.S. banking system, the domestic economic outlook has weakened amid tighter financial conditions and increased uncertainty. A weaker economy could put stress on households and businesses and, thus, on the banking system as a whole. Uncertainty has led to increased financial market volatility and may also reveal pockets of excess leverage and liquidity risk in the nonbank financial sector, which risks spillovers to the banking system and the real economy. We saw a host of such risks with the disruptions in the United Kingdom's gilt markets. The Federal Reserve will be heightening its focus on liquidity, credit, and interest-rate risks as supervised institutions manage the changing financial conditions.

In the wake of the pandemic, the global recovery is uneven, inflation is far too high, and geopolitical events pose downside risks to the U.S. and other economies

around the world. Russia's war of aggression is devastating for the people of Ukraine, and is also disrupting commodities, energy, and food markets, and pushing up inflation around the world. And these factors—along with China's economic slowing, associated with its inward turn, pandemic shutdowns, and contraction in its real estate sector—are weighing on global economic growth. We remain attentive to these and other developments and are closely supervising our regulated institutions to assess potential risks and implications for the stability of the U.S. and global financial systems.

Supervisory and Regulatory Priorities

Capital Review

Turning to a number of our priorities at the Federal Reserve, I am taking a holistic look at the Fed's capital framework to assess whether it is functioning as intended and supports a resilient financial system. Robust capital and liquidity requirements make it more likely that banks are able to absorb losses and continue their vital role supporting households and businesses. This is especially important for the largest and most complex banks, which pose the greatest risk to U.S. financial stability. We are taking a look at the G–SIB surcharge, the enhanced supplementary leverage ratio, stress testing, the countercyclical capital buffer, and other measures. Within this context, I am committed to working with my colleagues at the other Federal bank regulatory agencies in implementing enhanced regulatory capital requirements known as the "Basel III endgame" standards. [1]

When considering improvements to the regulatory capital framework, I will be guided by a few key principles: the capital framework should be forward-looking, should be tiered so that the highest standards apply to the riskiest firms, and should support a safer and fairer financial system. We will look at design choices that help to further these goals.

Resolution

In recent years, merger activity and organic growth have increased the size of large banks, which could complicate efforts by regulators to resolve those firms upon failure without disruption to customers and counterparties. The Board recently invited comment on an advance notice of proposed rulemaking to enhance regulators' ability to resolve large banks in an orderly way, should they fail. We look forward to the comments we will receive.

Merger Review

The Federal Reserve is also evaluating our approach to reviewing banks' proposed acquisitions. Mergers are often a feature of vibrant sectors, but the advantages that firms seek to gain through mergers must be weighed against the risks that mergers can pose to competition, consumers, and financial stability. A merged institution may be able to provide a wider range of products and services at lower prices. But if there is concentration, mergers could also reduce competition and access to financial services through higher prices or a reduced range of services. In addition, mergers of larger, more complex firms may pose risks to financial stability. We are also required to evaluate whether a merger would meet the convenience and needs of the community. The Federal Reserve—along with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC)—is reviewing the issues to see if any adjustments to our approach would be appropriate.

Crypto Activity

Another priority is monitoring the risk of crypto-asset-related activities. Over the last several years, we have seen crypto-asset activity grow rapidly and experience periods of significant stress. Some financial innovations offer opportunities, but as we have recently seen, many innovations also carry risks—which can include liquidity runs, the rapid collapse of asset values, misuse of customer funds, fraud, theft, manipulation, and money laundering. These risks, if not well controlled, can harm retail investors and cut against the goals of a safe and fair financial system. Most of this activity is occurring outside of the ambit of banking regulation. But recent events remind us of the potential for systemic risk if interlinkages develop between the crypto system that exists today and the traditional financial system. Crypto-asset-related activity, requires effective oversight that includes safeguards to ensure that crypto companies are subject to similar regulatory safeguards as other financial services providers.

I would note with some humility that striking the right balance between creating an environment that supports innovation and managing related risks to businesses,

[1] *https://wwwfederalreserve.gov/newsevents/pressreleases/bcreg20220909ahtm*

households, and the stability of the financial system is no easy task. We do not want to stifle innovation, but when regulation is lax or behind the curve, it can facilitate risk taking and a race to the bottom that puts consumers, businesses, and the economy in danger and discredits new products and services with consumers and investors. I believe everyone has a stake in getting the regulatory balance right.

We are working closely with the OCC and the FDIC to assess the risks and opportunities posed by a range of crypto-asset-related activities, and to clarify which activities are legally permissible and can be conducted by banks in a manner that is consistent with safety and soundness, consumer protection, and overall stability of the financial system.

Before leaving the topic of crypto assets, I would like to touch on stablecoins. Stablecoins, which like other instruments that purport to be available on demand at par value, can be subject to destabilizing runs and require strong Federal prudential oversight to mitigate their potential for economic harm. That is especially the case for stablecoins that aim to function as private money. Legislative action on crypto assets in general, and stablecoins in particular, would help promote responsible innovation and protect the financial system.

Climate-Related Financial Risks

We are also working to understand financial risks related to climate change. At the Federal Reserve, our mandate in this area is important, but narrow, and we are focused on our supervisory responsibilities and our role in promoting a safe and stable financial system. To that end, the Federal Reserve recently announced a pilot climate scenario analysis exercise designed to enhance the ability of supervisors and firms to measure and manage climate-related financial risks.

Scenario analysis—in which the resilience of financial institutions is assessed under different hypothetical climate scenarios—is an emerging tool to assess climate-related financial risks. The pilot climate scenario analysis exercise, which is distinct and separate from bank stress tests, will be exploratory in nature and not have capital consequences. It is also our intention to work with the OCC and the FDIC to provide guidance to large banks on how we expect them to identify, measure, monitor, and manage the financial risks of climate change.

Operational Resilience

The last priority I will mention is operational resilience. Financial institutions face significant challenges from a wide range of disruptive events. These include technology-based failures, cyber incidents, pandemics, and natural disasters. Such events, combined with banks' growing reliance on third-party service providers, expose them to a range of operational risks, which are often difficult to anticipate. When they manifest, these risks can affect the safety and soundness of affected banks and pose risks to U.S. financial stability by limiting market functioning or undermining trust in the system. We at the Federal Reserve will continue to work in this area to help ensure that banks understand and manage these complex and evolving challenges and that consumers remain protected. Additionally, we are committed to working closely with other domestic agencies and international authorities to coordinate on supervisory approaches to operational resilience.

Conclusion

As the banking system continues to evolve, we must ensure that supervision and regulation keeps up with those changes and are appropriate for the underlying risks. Over the coming months and years, it will be crucial to examine new risks to the banking system and whether and how the real economy, including consumer needs and access to financial services, may change. As vulnerabilities appear, a strong banking system will help households and businesses weather those challenges. As Vice Chair for Supervision, I will continue to work to promote a safe and fair banking system.

Thank you, and I look forward to your questions.

PREPARED STATEMENT OF TODD M. HARPER

CHAIR, NATIONAL CREDIT UNION ADMINISTRATION

NOVEMBER 15, 2022

Chairman Brown, Ranking Member Toomey, and Members of the Committee, thank you for inviting me to discuss the state of the credit union system and provide an update on the operations, programs, and initiatives of the National Credit Union Administration.

In the Federal Credit Union Act, Congress charged the NCUA with overseeing the credit union system to "make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States." The NCUA is committed to fulfilling this charge by protecting the system of cooperative credit and its member-owners through effective chartering, supervision, regulation, and insurance.

To further these important policy objectives, the NCUA Board in March 2022 unanimously adopted a 5-year strategic plan with three core goals.[1] Those strategic goals are:

- Ensuring a safe, sound, and viable system of cooperative credit that protects consumers;
- Improving the financial well-being of individuals and communities through access to affordable and equitable financial products and services; and
- Maximizing organizational performance to enable mission success.

This strategic plan and its goals will guide the agency's work through 2026.

In my testimony today, I will discuss the state of and the factors impacting the credit union system, review the NCUA's efforts to strengthen the credit union system and protect consumers, highlight several of the agency's recent rulemakings, and outline two key legislative requests.

State of the Credit Union System

While the COVID–19 pandemic's economic fallout and a rising interest rate environment have impacted credit union performance over the past year, federally insured credit unions (credit unions), the National Credit Union Share Insurance Fund (Share Insurance Fund), and the Central Liquidity Facility (CLF) have all remained on a solid footing.[2]

Credit Union System Performance

As of June 30, 2022, there were 4,853 credit unions with 132.6 million members.[3] The system's aggregate total assets were $2.1 trillion. Additionally, the system's net worth ratio rose to 10.42 percent, representing a recovery of 40 basis points from a pandemic low of 10.02 percent. Notably, at the end of the second quarter, credit unions recorded a 16.2 percent year-over-year increase in loans.

During the last decade, the credit union system has also experienced growth in size and complexity. Based on the most recent quarterly data, the number of credit unions with assets of at least $1 billion has more than doubled to 412 in the second quarter of 2022, compared to 193 in 2012. Together, these billion-dollar-plus credit unions held $1.6 trillion in assets—three out of every four dollars within the credit union system. These credit unions also reported the most growth in loans, membership, and net worth over the year ending in the second quarter of 2022.

Nevertheless, the credit union system continues to encompass mostly smaller institutions. Nearly two-thirds of all credit unions have less than $100 million in total assets. Smaller credit unions play an important role in providing safe, fair, and affordable financial products and services, particularly in rural areas, within communities of color, and to other underserved places across the country. Smaller credit unions also often face challenges to their long-term viability including lower returns on assets, declining membership, higher loan delinquencies, increasing non-interest expenses, and a lack of succession planning for boards and key personnel.[4]

Moving forward, all credit unions must remain diligent in managing safety and soundness and prepare for rising interest rates, inflationary pressures, and liquidity concerns. Through examinations and supervision, the NCUA continues to monitor economic conditions and these challenges, and the agency stands ready to act expeditiously, when needed, to address identified risks.

External Factors Impacting the System

In the coming year, the NCUA expects credit union performance to be influenced by several external factors. Forecasters expect modest economic growth resulting

[1] See *https://www.ncua.gov/files/agenda-items/strategic-plan-20220317.pdf.*

[2] The information contained in this testimony neither includes nor applies to privately insured credit unions.

[3] See *https://www.ncua.gov/files/publications/analysis/quarterly-data-summary-2022-Q2.pdf.*

[4] To address the issue of succession planning, the NCUA Board currently has under consideration a proposed rule to require boards of directors at Federal credit unions to establish and adhere to processes for succession planning. See *https://www.regulations.gov/docket/NCUA-2022-0016/document.*

from inflation and tighter credit conditions. Job growth is also expected to slow, placing moderate upward pressure on the unemployment rate.

Expected changes in the interest rate environment suggest the term spread could turn negative next year, squeezing credit union net interest margins. Therefore, the outlook for credit union loan growth and loan performance is uncertain. Modest growth in automobile and home sales is projected for next year, which should support continued growth in credit union loan balances.

Delinquency rates may drift higher—moving closer to prepandemic levels—but should stay relatively low. However, weaker-than-expected economic conditions or a downturn could produce less favorable outcomes for credit unions. Inflation may remain elevated as well due to geopolitical events, supply chain disruption, and material shortages.

Given rising interest rates, the NCUA updated its supervisory guidance in September to address market and interest rate risk. Specifically, the agency issued a letter to credit unions outlining changes to how it plans to supervise for interest rate risk and clarifying when the issuance of a document of resolution would be warranted.[5] Going forward, the NCUA will continue to monitor the interest rate environment and take further action, if needed.

Performance of the National Credit Union Share Insurance Fund

The Share Insurance Fund continues to perform well, with no premiums or distributions expected at this time.

By law, the NCUA Board is required to maintain a strong Share Insurance Fund, which is backed by the full faith and credit of the United States. This fund insures individual accounts up to $250,000. As of June 30, 2022, the Share Insurance Fund protected nearly $1.7 trillion in insured shares and deposits across all States, the District of Columbia, and U.S. territories. The Share Insurance Fund also reported a net income of $19.2 million and a net position of $20.3 billion for the second quarter ending June 30, 2022.

The Share Insurance Fund's equity ratio is the overall capitalization of the insurance fund to protect against unexpected losses. When the equity ratio falls below—or is projected within 6 months to fall below—1.20 percent, the NCUA Board must assess a premium or develop a restoration plan. Conversely, when the equity ratio exceeds the normal operating level—or the desired equity level of the Share Insurance Fund set between 1.20 percent and 1.50 percent—the Share Insurance Fund pays a distribution if the other statutory requirements are met.

At the end of the second quarter of 2022, the equity ratio stood at 1.26 percent. For the period ending December 31, 2022, NCUA projects the equity ratio for the Share Insurance Fund will be 1.30 percent, slightly below the 1.33 percent normal operating level set by the NCUA Board.

State of the Central Liquidity Facility

The NCUA remains concerned about access to liquidity for credit unions given rising interest rates and the increased probability of a liquidity event, combined with the expiration of previously approved statutory enhancements to the NCUA's CLF at the end of 2022.

Established by statute, the CLF is a mixed-ownership government corporation designed to improve financial stability by providing credit unions with a source of loans to meet seasonal, short-term, and protracted liquidity needs.[6] The CLF's ability to respond rapidly to events helps contain or avert liquidity crises before they escalate. For example, during the Great Recession and financial crisis of 2008, the NCUA's deployment of the CLF and Share Insurance Fund enabled many credit unions to survive.

Currently, corporate credit unions—or credit unions serving other credit unions—play a critical role to the system by subscribing to capital stock in the CLF to provide access to liquidity for smaller credit unions. While corporate credit unions may act as agent members to purchase capital stock of the CLF, the enhancements that allow for their ability to do so for a subset of credit union members will expire at the end of 2022, unless Congress acts to extend these authorities. Expiration of this provision will make agent membership in the CLF for corporate credit unions cost prohibitive, and it will increase the administrative burden of smaller credit unions to use the CLF for their liquidity needs.

To address this expiration, the NCUA Board has strongly advocated for permanent statutory authority—or at minimum, an extension—to allow corporate credit unions and other agent members of the CLF to purchase capital stock for a subset

[5] See SL No. 22-01, Updates to Interest Rate Risk Supervisory Framework.
[6] See *https://www.ncua.gov/support-services/central-liquidity-facility.*

of credit unions served. Smaller credit unions are more likely to need access to emergency funds should a systemic liquidity event occur. These statutory CLF enhancements make the facility a more affordable option for corporate credit unions to subscribe to on behalf of their smaller credit union members.

If the CLF agent-member provision is not permanently reinstated or extended, there could be a reduction of $9.7 billion in reserve liquidity for the credit union system. Given increasing liquidity concerns within the credit union system, now is not the time to shrink access to an emergency liquidity resource.

NCUA's Efforts To Strengthen the Credit Union System

Over the last year, the NCUA has undertaken several actions to strengthen capital standards, improve the examination process, enhance cybersecurity, protect consumers, preserve Minority Depository Institutions (MDIs), and advance diversity, equity, and inclusion.

Strengthening Capital Standards

The NCUA recognizes that all financial institutions backed by Federal share and deposit insurance, including credit unions, should hold capital commensurate with their risks. In 2015, the NCUA Board initially approved a risk-based capital rule (RBC rule) to update, consistent with the Federal Credit Union Act, the risk-based net worth requirement for complex credit unions.[7] The intent was to reduce the likelihood of a small number of high-risk outliers exhausting their capital and causing losses to the Share Insurance Fund.

Effective January 1, 2022, all federally insured, consumer credit unions defined as complex must comply with the RBC rule. The RBC rule defines a complex credit union as one having more than $500 million in assets. Should one of these credit unions fail, the additional capital buffer afforded by this framework would protect surviving credit unions, their members, and the taxpayers who ultimately guarantee the Share Insurance Fund.

To provide a simplified alternative framework to the risk-based capital requirements, the NCUA Board approved the Complex Credit Union Leverage Ratio final rule (CCULR rule) in December 2022. The CCULR rule relieves complex credit unions that satisfy certain eligibility criteria from calculating the risk-based capital ratio. In exchange, these credit unions must maintain a higher net worth ratio than otherwise required for the well-capitalized classification.

The CCULR rule provides complex credit unions with a risk-based capital framework comparable to those developed by the Federal banking agencies and consistent with the Federal Credit Union Act. The rule also strengthens the system's capital levels while providing complex credit unions with a streamlined approach to managing their capital.

Together, the CCULR and RBC rules promote responsible capital levels across the credit union system and reduce the Share Insurance Fund premiums surviving credit unions would pay if a large, complex credit union failed. The rules also strengthen the credit union system's ability to better withstand future crises with minimal disruption to credit union members.

Upgrading Legacy Examination Tool

As part of the NCUA's innovation efforts, the agency has developed a new examination tool to modernize the examination process and offer examiners enhanced analytics capabilities. The NCUA officially rolled out its new Modern Examination and Risk Identification Tool (MERIT) in 2022 after conducting training for State and Federal credit union examiners in 2021. This cloud-based examination platform replaced the NCUA's Automated Integrated Regulatory Examination System (AIRES), a 25-year-old legacy examination application. The NCUA expects MERIT will help examiners more efficiently perform their functions and apply better analytics, which should result in fewer onsite examination hours.

Maintaining Cybersecurity

Over the last year, the NCUA has continued to reinforce the credit union system's ability to withstand potential cyberattacks and strengthen the cybersecurity of credit unions and the NCUA. One of the agency's notable actions includes warning credit unions about potential threats stemming from malicious cyber activity against the United States in response to sanctions imposed on Russia for its war in Ukraine. The NCUA has also completed the development of a new IT examination tool, encouraged credit union use of the Automated Cybersecurity Evaluation Toolbox (ACET), and offered cybersecurity grants to eligible low-income credit unions.

[7] 12 U.S.C. 1790d(b)(1).

To protect the credit union system from the cyberattacks of foreign adversaries and other bad actors, the NCUA has regularly provided guidance and resources to credit unions regarding these potential threats.[8] As part of this guidance, the NCUA recommends credit unions report cyber incidents to the NCUA, the Federal Bureau of Investigation, and the Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA). The NCUA has also directed credit unions to CISA's Shields-Up website,[9] which provides information about cybersecurity threats, resources, and mitigation strategies.

Additionally, the prevalence of ransomware, malware, supply-chain vulnerabilities, social engineering, insider threats, and other forms of cyber intrusion are continuing to create challenges at credit unions of all sizes. These threats require ongoing measures for rapid detection, protection, response, and recovery and are likely to accelerate in the future. In response, the NCUA will soon begin deployment of its new Information Security Examination (ISE) program. ISE is a scalable, risk-focused examination system that focuses on compliance with the NCUA's information system regulations.

The NCUA has also created ACET for credit unions to use when evaluating their levels of cybersecurity preparedness. ACET works in tandem with ISE, giving credit unions a better understanding of the cybersecurity issues the NCUA will address during the examination process. ACET is a downloadable, standalone application developed to be a holistic cybersecurity resource for credit unions. ACET incorporates standards and practices established for financial institutions across the cybersecurity discipline, like the Federal Financial Institutions Examination Council's IT Examination Handbooks and the National Institute of Standards and Technology's Cybersecurity Framework.

Finally, to help improve digital services and cybersecurity, the NCUA provides Community Development Revolving Loan Fund (Revolving Loan Fund) grants and loans to low-income-designated credit unions. Congress created the Revolving Loan Fund to stimulate economic development in low-income communities served by credit unions. During the 2022 grant round, 52 grants totaling $484,165 were specifically provided for digital services and cybersecurity projects.

Ensuring Consumer Financial Protection

Consumer financial protection is an NCUA supervisory priority, equally important as safety and soundness. This year, NCUA examiners are reviewing credit union compliance with COVID–19 consumer-assistance programs, fair lending rules, servicemember protections, and fair credit reporting laws. The NCUA is also conducting more fair lending examinations and reviews than in prior years. Of note, the NCUA has found compliance management system weaknesses during recent fair lending examinations and reviews.

In addition, the NCUA has included a review of credit union overdraft programs as a supervisory priority. In particular, the agency is focusing on credit unions' use of overdraft protection programs and the safety-and-soundness issues that can occur with over-reliance on these programs. Further, the overdraft fees charged by some credit unions can be detrimental to members and inconsistent with the system's mission. For that reason, examiners are requesting information about overdraft policies and procedures and audits of credit union overdraft programs. The agency is also reviewing credit union communications with members about these programs. The information gathered this year may be used for a more thorough review of credit unions' overdraft programs in 2023.

Ultimately, the NCUA recognizes that a strengthened consumer compliance program is in the best interest of the system and its members.

Supporting MDIs and Low-Income Designated Credit Unions

The NCUA is also developing more tailored examination procedures for MDI and low-income designated credit unions to assist examiners in supervising these institutions based on their unique strategies and member needs.

MDI and low-income credit unions are important to providing access to safe, fair, and affordable financial services and products, particularly to underserved individuals and communities. As of June 30, 2022, 507 credit unions had the MDI designation, and 412 MDI credit unions held the low-income designation. In all, MDI credit unions served more than 5 million members and held more than $65 billion in assets.

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[8] See *https://www.ncua.gov/regulation-supervision/regulatory-compliance-resources/cybersecurity-resources.*

[9] See *https://www.cisa.gov/shields-up.*

Despite the ongoing challenges to the economy and the financial system resulting from the COVID–19 pandemic, MDI credit unions generally saw improved financial performance in 2021. While the number of MDIs declined slightly, membership, assets, and loans grew. For example, the total amount of MDI credit union lending rose by $2.9 billion during 2021, an increase of more than 9 percent over the prior year and a higher growth rate than credit unions overall. [10]

Additionally, a critical component of the NCUA's efforts to support credit unions is the low-income designation. To qualify as a low-income designated credit union, a majority of the credit union's membership (50.01 percent) must meet certain income thresholds based on data from the Census Bureau and requirements outlined in the NCUA's rules and regulations. As of the end of the second quarter of 2022, more than 2,600 credit unions with low-income designations served more than 68 million members and held in excess of $1 trillion in assets.

Advancing Diversity, Equity, and Inclusion

The NCUA is committed to fostering diversity, equity, and inclusion within the agency and the credit union system. The agency understands that diversity, equity, and inclusion drive fairness, employee engagement, and effective decision making. Additionally, organizations that embrace diversity, equity, and inclusion often experience higher workforce engagement, greater employee retention, and increased organizational productivity and earnings.

As noted in the NCUA's 2021 OMWI Report to Congress, [11] the agency's diversity, equity, and inclusion efforts helped attract, hire, and retain a diverse workforce; led to an increase in hiring of employees with disabilities; and led to an increase in contracting dollars awarded to minority- and women-owned businesses. In 2021, two of every five new hires were people of color; more than half the participants in leadership development programs were female; and nearly 4 out of every 10 contract dollars went to minority- and women-owned businesses.

Despite this progress, the NCUA recognizes that Hispanic and Latino professionals remain underrepresented within the agency's ranks. The agency also needs to improve its performance in hiring and retaining women. As such, the NCUA is developing recruitment and development strategies to increase representation of both these demographic groups.

Lastly, the NCUA's annual voluntary Credit Union Diversity Self-Assessment (CUDSA) results showed improvements over the last year. [12] In 2021, 240 credit unions participated in the survey—a 28 percent increase from 2020. Among the highlights for 2021, 61 percent of responding credit unions reported a leadership and organizational commitment to diversity, 56 percent reported taking steps to implement employment practices to demonstrate that commitment, and 31 percent reported monitoring and assessing their diversity policies and practices. As part of the 2022 CUDSA cycle, the NCUA has also made several improvements to enhance security, ensure data integrity, and improve the overall user experience.

Finally, the agency hosted its third industrywide summit on diversity, equity, and inclusion at the start of November. [13] The in-person and online hybrid event attracted hundreds of diversity, equity, and inclusion advocates and practitioners. Going forward, the NCUA will continue to host similar summits annually and encourage more credit unions to complete the CUDSA.

Rulemaking and Guidance

As the financial services system and credit unions continue to evolve—especially with many credit unions growing larger and more complex—the regulatory framework must keep pace to maintain the strength and stability of the credit union system. In response to these changes and to legislation enacted into law, the NCUA has undertaken several rulemakings or implemented new rules during the last year that address member expulsion, subordinated debt, emergency capital investments, and cybersecurity notifications. The NCUA has also issued guidance on the use of distributed ledger technologies.

Member Expulsion

On September 22, 2022, the NCUA Board unanimously approved a proposed rule to develop a policy by which a Federal credit union member may be expelled for cause by a two-thirds vote of a quorum of the Federal credit union's board of direc-

[10] See *https://www.ncua.gov/files/publications/2021-mdi-congressional-report.pdf.*
[11] See *https://www.ncua.gov/files/publications/2021-omwi-congressional-report.pdf.*
[12] See *https://www.ncua.gov/files/publications/2021-cudsa-report.pdf.*
[13] See *https://www.ncua.gov/news/dei-access-summit-2022.*

tors.[14] This proposal would implement the Credit Union Governance Modernization Act, passed by Congress in March 2022.[15] Comments on the proposed rule are due December 2, 2022.

Subordinated Debt/Secondary Capital Rule

Effective January 1, 2022, the NCUA Board adopted a final subordinated debt rule that replaced the previous secondary capital rule.[16] The final rule allows eligible credit unions to issue subordinated debt under the statutory authority to borrow from any source.

Among the changes included in the final rule were increased categories of credit unions eligible to use subordinated debt for purposes of regulatory capital treatment. This rule now permits low-income-designated credit unions, as well as complex credit unions that are not low-income-designated, to count qualifying subordinated debt to meet certain capital requirements. This rule also enables newly chartered credit unions to use subordinated debt to support their startup phase.

Subordinated debt, as defined by NCUA's regulation, can help increase regulatory capital levels to protect against future losses and enable credit unions to provide lending and other member services to under-resourced communities.

Emergency Capital Investment

In December 2021, the Board approved amendments to the Subordinated Debt rule to address Emergency Capital Investment Program (ECIP) secondary capital applications approved and scheduled for funding after the final rule went into effect.[17] This change benefits eligible MDI or Community Development Financial Institutions credit unions that are either participating in the U.S. Department of Treasury's ECIP or other programs administered by the U.S. Government.

Credit unions, for the most part, have completed receiving approximately $2 billion in ECIP investments. It is expected upon completion that close to 80 credit unions will have received ECIP investments. ECIP funding will provide long-term, low-cost regulatory capital for participating institutions to support low-income and minority communities. Such efforts are consistent with the statutory mission of credit unions to serve the credit and savings needs of their members, especially those of modest means.

Cyber Incident Notification

As part of the NCUA's cybersecurity efforts, the agency proposed a cyber incident notification rule that would require a credit union to notify the agency as soon as possible, but no later than 72 hours, after it reasonably believes a reportable cyber incident has occurred.[18] The rule would provide an early alert to the NCUA and other agencies, allowing the Government and the private sector to react to threats before they become systemic.

To that end, the proposed rule would set parameters for what constitutes a reportable incident and the minimum notification requirements. The proposed rule is intended to align where possible with the Cyber Incident Reporting for Critical Infrastructure Act signed into law in March.[19] The proposed rule would also bring the NCUA's cyber incident reporting framework into general alignment with the Federal banking agencies.

Use of Distributed Ledger Technologies

The NCUA recognizes that the maturing of financial technology is creating opportunities for credit unions to increase speed of service, improve security, and expand products and services. To assist credit unions regarding financial technology adoption in a safe-and-sound manner, the NCUA issued a letter to credit unions that clarifies expectations for credit unions contemplating the use of new or emerging distributed ledger technologies (DLT).[20] The letter specifies that while the NCUA does not prohibit credit unions from developing, procuring, or using DLT, the technology used must be deployed for permissible activities and in compliance with State and Federal laws and regulations.

[14] See *https://www.regulations.gov/document/NCUA-2022-0132-0001.*
[15] Pub. L. 117-103 (Mar. 15, 2022).
[16] See *https://www.regulations.gov/docket/NCUA-2020-0016/document.*
[17] See *https://www.regulations.gov/docket/NCUA-2022-0040/document.*
[18] See *https://www.regulations.gov/docket/NCUA-2022-0099/document.*
[19] Pub. L. 117-103 (Mar. 15, 2022).
[20] See 22-CU-07, Federally Insured Credit Union Use of Distributed Ledger Technologies.

Legislative Requests

The NCUA recognizes that laws and regulations must evolve to reflect changes in the economic environment and technological advances. Accordingly, there are two legislative changes that I would like to highlight. The first change relates to the CLF agent-membership requirements mentioned earlier in this testimony. Extension of this provision by Congress would allow the CLF to continue to provide a shock absorber that will allow the credit union system to better withstand liquidity events. The second change concerns restitution of the agency's vendor authority. Action by Congress on this legislative recommendation would close a growing regulatory blind spot. Enactment of both legislative proposals would facilitate the ability of the NCUA to fulfill its statutory mission.

Central Liquidity Facility Permanency

Most timely, the NCUA requests Congress permanently adjust the CLF agent-member requirements to allow agent members to purchase capital stock for a subset of credit unions served. Permanent agent membership would make it economically feasible for agent members, such as corporate credit unions, to participate in the CLF. The statutory change would protect the taxpayer at no cost, provide a buffer for the Share Insurance Fund, maintain immediate access to emergency liquidity for more than 3,600 credit unions with assets under $250 million, and support the financial services sector in a liquidity event.

If the current CLF enhancements—which expire at year's end—are not permanently adopted by Congress or if a statutory extension is not provided, there will be a decline in the CLF's capitalization and funding capacity as corporate credit unions are "priced out." Given the prohibitive cost of the stock purchase for all institutions a corporate credit union serves, many corporate credit unions have already announced plans to terminate membership at the end of this calendar year if the agent-member provision is not extended or made permanent.

Permanence would provide regulatory certainty for smaller credit unions and strengthen the system's ability to respond to future emergencies. The House Financial Services Committee has favorably reported H.R. 3958, the Central Liquidity Facility Enhancement Act, and the language to renew this expiring enhancement for an additional year is contained in the House-passed 2023 National Defense Authorization Act.

Restoration of Third-Party Vendor Authority

The NCUA also seeks the restoration of statutory examination and enforcement authority over third-party vendors—including credit union service organizations (CUSOs)—that expired at the end of 2001. This statutory change would give the NCUA parity with other agencies that supervise and regulate federally insured depository institutions.

Currently, the NCUA may only review credit union third-party vendors with their permission, and often, vendors decline these requests. Vendors and CUSOs may also reject NCUA recommendations to implement appropriate corrective actions that mitigate identified risks. The NCUA needs visibility into these entities for several reasons, including the credit union system's growing reliance on digital services, increased credit union outsourcing of core business functions and resulting concentration risks, and cybersecurity, which could be a national security risk given this lack of oversight.

For these reasons, the Government Accountability Office, the Financial Stability Oversight Council, and the NCUA's Office of Inspector General have each recommended that Congress pass legislation to restore the NCUA's vendor authority. The preamble to the CUSO final rule adopted in October 2021 also noted the NCUA Board's "continuing policy to seek third-party vendor authority for the agency from Congress."[21] If the NCUA's third-party vendor authority is reauthorized, the agency will adopt a program that prioritizes examinations based on risk to the Share Insurance Fund, cybersecurity, consumer financial protection, Bank Secrecy Act/Anti-Money Laundering compliance, and national security issues.

The U.S. House of Representatives passed legislation to provide NCUA third-party vendor authority within the 2023 National Defense Authorization Act. In the Senate, bipartisan legislation has been introduced, which if enacted, would enable the NCUA to develop a risk-focused examination program for CUSOs and third-party vendors.[22]

I would like to extend my appreciation to the Committee for its continued support and thank Senators Ossoff, Lummis, and Warner for introducing S. 4698, the Im-

[21] See *https://www.ncua.gov/files/agenda-items/AG20211021Item2b.pdf.*
[22] See *https://www.congress.gov/bill/117th-congress/house-bill/7900.*

proving Cybersecurity of Credit Unions Act, to restore the NCUA's third-party vendor examination authority. The enactment of this legislation would close this regulatory blind spot the NCUA continues to confront.

Conclusion

Thank you again for the invitation to testify about the NCUA's work and the state of the credit union system. As the NCUA continues to navigate through a challenging and changing economic environment, the NCUA will stay focused on protecting credit union members, ensuring the safety and soundness of credit unions, and insulating the Share Insurance Fund from losses. By attending to these issues, the NCUA Board and staff will keep the credit union system strong and ensure greater access to safe, fair, and affordable financial products and services for all Americans, including those of modest means. I look forward to your questions.

PREPARED STATEMENT OF MARTIN J. GRUENBERG

ACTING CHAIR, FEDERAL DEPOSIT INSURANCE CORPORATION

NOVEMBER 15, 2022

Chairman Brown, Ranking Member Toomey, and Members of the Committee, I am pleased to appear today at this hearing on "Oversight of Financial Regulators: A Strong Banking System for Main Street".

The core mission of the Federal Deposit Insurance Corporation (FDIC) is to maintain stability and public confidence in the U.S. financial system. The FDIC carries out this mission through its responsibilities for deposit insurance, banking supervision, and the orderly resolution of failed banks, including systemically important financial institutions. Banking supervision encompasses safety and soundness and consumer protection, both of which are essential to this important responsibility. I appreciate the opportunity to report on the agency's work in carrying out these responsibilities and to address the specific issues raised by the Committee in its letter of invitation.

My written testimony will begin with an overview of the condition of the banking industry and the FDIC's Deposit Insurance Fund (DIF). I will then update the Committee on five key policy priorities for 2022: strengthening the Community Reinvestment Act (CRA); addressing the financial risks that are likely to affect banking organizations and the financial system as a result of climate change; reviewing the bank merger process; evaluating the risks of crypto assets to the banking system; and finalizing the Basel III capital rules. I will then discuss the FDIC's efforts to support Minority Depository Institutions (MDIs) and Community Development Financial Institutions (CDFIs), as well as to promote a diverse and inclusive workplace at the FDIC. Finally, I will describe the FDIC's work to strengthen cybersecurity and information security within the banking industry and our return to in-person bank examinations and other in-person activities at every level of the FDIC.

State of the Banking Industry

The banking industry has reported generally positive results this year, amid continued economic uncertainty. Loan growth strengthened, net interest income grew, and most asset quality measures improved. Further, the industry remains well-capitalized and highly liquid.[1] The number of institutions on the FDIC's "Problem Bank List" remained stable in the second quarter at 40, the lowest number in the FDIC's Quarterly Banking Profile history. Fourteen new banks opened through October 2022, including the first mutual bank in 50 years. Additionally, no banks failed during 2021 nor this year.

At the same time, the banking industry reported a moderate decline in net income in the first two quarters of this year from 1 year ago, primarily because of an increase in provision expense at the largest institutions. The increase in provision expense—the amount set aside by institutions to protect against future credit losses—reflects the banking industry's recognition of risks related to persistent economic uncertainties, and slowing economic growth, as well as the increase in loan balances. Net income also declined year-over-year at community banks. Unlike results for the industry as a whole, an increase in compensation costs led the decline in net income at community banks.

Rising market interest rates and strong loan growth supported an increase of 26 basis points in the banking industry's net interest margin (NIM) from the first to

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[1] See FDIC Quarterly Banking Profile: Second Quarter 2022 (September 8, 2022) available at *https://www.fdic.gov/analysis/quarterly-banking-profile/*.

the second quarter of this year to 2.80 percent. Most banks reported higher net interest income compared with a year ago as a result.

However, rising interest rates and longer asset maturities also resulted in unrealized losses on investment securities held by banks. As of the second quarter 2022, banks reported $470 billion in unrealized losses, as the market value of securities fell below the book value. The FDIC expects this trend to be an ongoing challenge as interest rates continued to rise in the third quarter, especially if banks need to sell investments to meet liquidity needs.

Despite several favorable performance metrics, the banking industry continues to face significant downside risks. These risks include the effects of inflation, rapidly rising market interest rates, and continuing geopolitical uncertainty. Taken together, these risks may reduce profitability, weaken credit quality and capital, and limit loan growth in coming quarters. Furthermore, higher market interest rates have led to continued growth in unrealized losses in the banking industry's securities portfolios. Higher interest rates may also erode real estate and other asset values as well as hamper borrowers' loan repayment ability. These will be matters of ongoing supervisory attention by the FDIC.

Condition of the Deposit Insurance Fund

Extraordinary growth in insured deposits during the first half of 2020 caused the DIF reserve ratio to decline below the statutory minimum of 1.35 percent as of June 30, 2020. The reserve ratio of the DIF is the DIF balance as a percent of the banking industry's estimated insured deposits.

On September 15, 2020, the FDIC adopted a Restoration Plan as required by law to restore the reserve ratio to the statutory minimum of 1.35 percent within the statutory 8-year period, ending on September 30, 2028.[2] The Restoration Plan maintained the assessment rate schedules in place at the time and required the FDIC to update its analysis and projections for the DIF balance and reserve ratio at least semiannually.

While the DIF balance increased by about $1.3 billion over the first half of 2022 to $124.5 billion, continued elevated levels of insured deposits have caused the reserve ratio to remain low at 1.26 percent as of June 30, 2022, well below the statutory minimum.

While insured deposits have shown signs of possibly normalizing, the banking industry continued to report strong insured deposit growth through June 2022, outpacing growth in the DIF. Projections of the reserve ratio under different scenarios indicated that the reserve ratio was at risk of not reaching 1.35 percent by the statutory deadline. Consequently, the FDIC Board amended the Restoration Plan to incorporate an increase in assessment rate schedules of 2 basis points for all insured depository institutions, and concurrently approved a notice of proposed rulemaking to implement this increase.[3]

The increase in assessment rate schedules is intended to improve the likelihood that the reserve ratio will reach the statutory minimum of 1.35 percent by the statutory deadline. It will also support growth in the DIF in progressing toward the FDIC's long-term goal of a 2 percent Designated Reserve Ratio, and will increase the likelihood of the DIF remaining positive throughout periods of significant losses due to bank failures, consistent with the FDIC's long-term fund management plan.

Following careful consideration of the comments received on the proposal, and based on updated projections and analysis, on October 18, 2022, the FDIC adopted a final rule implementing the increase in assessment rate schedules of 2 basis points.[4] Under the final rule, the new assessment rate schedules will take effect on January 1, 2023. Assessments will be calculated at the end of the first quarter of 2023 and will be payable by June 30, 2023. Banks will have ample time to plan for the new assessment rates. The FDIC projects the increase in assessment rates will have an insignificant effect on institutions' capital levels and estimates the new rates will reduce income only slightly by an annual average of 1.2 percent. The FDIC does not expect the increase to impact lending or credit availability in any meaningful way.

As noted previously, the banking industry's current performance is strong, but it faces significant downside risks. It is better to take prudent but modest action earlier in the statutory 8-year period to reach the minimum reserve ratio of the DIF while the industry is in a strong position than to delay and potentially have to con-

[2] See Federal Deposit Insurance Corporation Restoration Plan, 85 FR 59306 (published September 21, 2020).

[3] See Federal Deposit Insurance Corporation Amended Restoration Plan, 87 FR 39518 (published July 1, 2022).

[4] 87 FR 64348 (published October 24, 2022).

sider a procyclical assessment increase. In the event that the industry experiences a downturn before the FDIC has exited its current Restoration Plan, the FDIC might have to consider even larger assessment increases to meet the statutory requirement in a more compressed timeframe and under less favorable conditions.

Strengthening the Community Reinvestment Act

The Community Reinvestment Act seeks to address one of the most intractable challenges of our financial markets—access to credit, investment, and basic banking services for low- and moderate-income communities and borrowers, both urban and rural.

The provisions of CRA as originally enacted in 1977 were deceptively simple but groundbreaking.[5] The key operative provision of the Act states, "In connection with its examination of a financial institution, the appropriate Federal financial supervisory agency shall[6] . . . assess the institution's record of meeting the credit needs of its entire community, including low- and moderate-income neighborhoods . . . ."

Since its enactment, CRA has become the foundation of responsible finance for low- and moderate-income communities in the United States.

While the rule implementing CRA has not undergone a major revision since 1995, the banking industry has evolved dramatically over that time. On May 5, the three Federal banking agencies—the Federal Reserve Board (Federal Reserve), the Office of the Comptroller of the Currency (OCC), and the FDIC adopted a Notice of Proposed Rulemaking (NPR) in an effort to adapt CRA to that evolution and to strengthen and enhance its effectiveness in achieving its core mission.[7] There is a lot in this NPR, but in the interest of brevity, I would like to focus on four key elements of the proposed rule.

First, the NPR would establish new retail lending assessment areas to allow for CRA evaluation in communities where a bank may be engaging in significant lending activity but where the bank does not have a branch. Currently, CRA assessment areas are tied to bank branches. Bank lending in communities in which the bank does not have a physical presence is generally not subject to CRA. While bank branches continue to play a critical role in serving communities, technology has made possible an increasing portion of bank lending activity unrelated to the branch network. Some banks have only one branch or no branch at all, yet engage in large scale lending.

These new retail lending assessment areas are a means of subjecting that lending activity to a CRA review. They represent a critically important adaptation of CRA to the changing nature of the banking business, and they do so in a manner that is neutral with regards to the business model of the bank. In addition, under the new community development test in the NPR, a bank could earn community development credit under the CRA evaluation for activity outside of the traditional branch-based assessment areas. This provides an incentive for bank activity in rural communities, Native lands, areas of persistent poverty, and underserved areas—so-called credit deserts.

Second, the NPR incorporates detailed metrics on bank lending activity. This provides an improved line of sight into bank lending and allows for the consideration of higher standards for bank lending performance under CRA. The objective here is to provide an incentive for increased bank lending to underserved communities.

Third, the availability of metrics will allow for greater transparency and certainty for banking institutions in meeting their CRA responsibilities under the retail lending and the community development financing tests. This is an objective on which the banking industry has placed a high value.

Finally, the NPR is tailored to the size and complexity of banking institutions with different standards for small, intermediate, and large institutions. For example, the NPR raises the thresholds for defining both "Small Bank" and "Intermediate Bank." This will maintain or reduce the requirements for hundreds of community banks with regards to CRA data collection and reporting.

In addition to these four core elements of the NPR, the proposed rule provides greater transparency on lending to communities of color utilizing publicly available information. It also provides enhanced incentives for bank collaboration with MDIs and CDFIs, bank investments in disaster preparedness and climate resilience in low- and moderate-income neighborhoods, and bank lending, investment, and services in rural communities and Native lands.

[5] Community Reinvestment Act of 1977, Pub. L. No. 95-128, title VIII, (1977).

[6] Id. at Sec. 802.

[7] See Joint Notice of Proposed Rulemaking: Community Reinvestment Act, 87 FR 33884 (published June 3, 2022), available at *https://www.govinfo.gov/content/pkg/FR-2022-06-03/pdf/2022-10111.pdf.*

Taken together this NPR represents a major revision of CRA intended to strengthen its impact and increase its transparency and predictability. The three banking agencies received approximately one thousand unique comments from a wide range of stakeholders, many of which are quite detailed and thoughtful.[8] The staffs of the three agencies are working diligently to review those comments and consider possible changes to the NPR in response to those comments in crafting a final rule.

Addressing the Financial Risks Posed by Climate Change

There is broad consensus among financial regulatory bodies, both domestically and abroad, that the effects of climate change and the transition to reduced reliance on carbon-emitting sources of energy present unique and significant economic and financial risks, and therefore, an emerging risk to the financial system and the safety and soundness of financial institutions.

The role of the FDIC with respect to climate change is limited to the financial risks that climate change may pose to the banking system and the extent to which those risks impact the FDIC's core mission and responsibilities. The FDIC is not responsible for climate policy. As such, we will not be involved in determining which firms or business sectors financial institutions should do business with. These types of credit allocation decisions are the responsibility of financial institutions. We want financial institutions to fully consider climate-related financial risks—as they do all other risks—and continue to take a risk-based approach in assessing individual credit and investment decisions.

The financial system has always had severe weather events to contend with and, thus far, the banking industry has handled these events well. Agricultural banks know well the effects that drought conditions can have on farming communities; banks in the west understand the impacts of wildfires; and coastal banks have long responded to the annual threat of tropical storms and hurricanes.

However, changing climate conditions are bringing with them challenging trends and events, including rising sea levels, increases in the frequency and severity of extreme weather events, and other natural disasters.[9] These trends challenge the future resiliency of the financial system and, in some circumstances, may pose safety and soundness risks to individual banks. The goal of the FDIC's work on climate-related financial risk is to ensure that the financial system continues to remain resilient despite these rising risks.

In order to understand and address the financial risks that climate change poses to financial institutions and the financial system, it is important to foster an open dialogue with our counterparts in the U.S. and international financial regulatory bodies, and especially with stakeholders throughout the banking industry. It is for these reasons that the FDIC established an internal, cross-disciplinary working group to assess the safety and soundness and financial stability considerations associated with climate-related financial risk and to develop an agencywide understanding of climate-related financial risk. The FDIC is also coordinating with our interagency peers and is participating on the Financial Stability Oversight Council's (FSOC) Climate-related Financial Risk Committee. Further, as climate change is an international problem, the FDIC, along with the Federal Reserve and the OCC, have joined the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) to foster collaboration and share best practices in addressing climate-related financial risks on a global basis. This complements our existing work with the Basel Committee's Task Force on Climate-related Financial Risks and other appropriate international organizations.

While the FDIC remains in the early stages of addressing climate-related financial risk, regulators need to work with the banking industry now to support financial institutions as they develop plans to identify, monitor, and manage the risks posed by climate change. This should be done in a manner that is flexible enough to allow for change as knowledge is gained, data are developed, and new methodologies and tools are explored. Consistent with this, the FDIC issued a request for comments in April on draft principles that would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks for large

[8] Comment submission closed on August 5, 2022. Comments received on the proposed changes to the Community Reinvestment Act are available at *https://www.regulations.gov/docket/OCC-2022-0002/comments.*

[9] See Intergovernmental Panel on Climate Change (2021; in press), "Summary for Policymakers", in V. Masson-Delmotte, P. Zhai, A. Pirani, S.L. Connors, C. Pean, S. Berger, N. Caud, Y. Chen, L. Goldfarb, M.I. Gomis, M. Huang, K. Leitzell, E. Lonnoy, J.B.R. Matthews, T.K. Maycock, T. Waterfield, O. Yelekci, R. Yu, and B. Zhou, eds., *Climate Change 2021: The Physical Science Basis*. Contribution of Working Group I to the Sixth Assessment Report of the Intergovernmental Panel on Climate Change (Cambridge, UK: Cambridge University Press).

financial institutions.[10] This request for comments is substantively similar to the principles that were issued by the OCC in December of last year.[11] Comments received on the proposed principles are currently under review and consideration.[12] The FDIC and OCC are also collaborating with the Federal Reserve to bring the three agencies into alignment on the principles.

I want to stress that the FDIC is still in the beginning stages of our work on climate-related financial risks, and we will continue to expand our efforts to address these risks through a thoughtful and measured approach. We will emphasize risk-based assessments and collaboration with other supervisors as well as with stakeholders in the banking industry, and our actions will complement actions that have been taken domestically and internationally. Importantly, the FDIC will continue to encourage financial institutions to consider climate-related financial risks in a manner that allows banks to prudently meet the financial services needs of their communities.

Reviewing the Bank Merger Process

The Bank Merger Act of 1960 (BMA) established a framework that requires, in general, approval by the Federal Reserve and the OCC, or the FDIC, as appropriate, of bank mergers.[13] FDIC approval is also required for a bank merger with a non-insured entity.[14] The statute generally requires the banking agencies to consider several factors when reviewing a merger application including whether a proposed merger would substantially lessen competition or tend to create a monopoly, the financial and managerial resources and future prospects of the existing and proposed institutions, the convenience and needs of the community to be served, and the risk to the stability of the United States banking or financial system.[15] The FDIC has adopted a rule and a policy statement implementing the statutory requirements but neither yet address the financial stability factor, which was added to the BMA under the Dodd-Frank Act of 2010.[16]

Although there has been a significant amount of consolidation in the banking sector over the last 30 years, facilitated in part by mergers and acquisitions, there has not been a significant review of the implementation of the BMA by the agencies in that time. Additionally, the prospect for continued consolidation among both large and small banks remains significant. In light of these circumstances, a review of the regulatory framework implementing the BMA is both timely and appropriate.

In March, the FDIC Board submitted to the Federal Register a Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions (RFI).[17] The RFI requested comment on the four statutory factors the FDIC must consider in reviewing bank merger applications: competition, prudential risk, the convenience and needs of the communities affected, and financial stability.

The comment period closed on May 31, 2022, with 31 comments received.[18] The FDIC is considering updates to its BMA Statement of Policy in light of the comments received. Moreover, the FDIC is working collaboratively with the other bank-

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[10] See Statement of Principles for Climate-Related Financial Risk Management for Large Financial Institutions, 87 FR 19507 (published April 4, 2022).

[11] OCC Bulletin 2021-62, Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks; Request for Feedback (December 16, 2021). *https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-62.html.*

[12] Comment submission closed on June 3, 2022. Comments received are available at *https://www.fdic.gov/resources/regulations/federal-register-publications/2022/2022-statement-principles-climate-related-financial-risk-management-3064-za32.html.*

[13] Bank Merger Act, Pub. L. 86-463, 72 Stat. 129 (1960); Bank Merger Act Amendments of 1966, Pub. L. 89-356, (codified as amended at 12 U.S.C. 1828(c)(2018)), available at *https://www.fdic.gov/regulations/laws/rules/1000-2000.html#1000sec.18c.*

[14] 12 U.S.C. §1828(c)(1) and (2).

[15] 12 U.S.C. §1828(c)(5).

[16] 12 CFR part 303, available at *https://www.fdic.gov/regulations/laws/rules/2000-250.html* and 63 FR 44762, August 20, 1998, effective October 1, 1998; amended at 67 FR 48178, July 23, 2002; 67 FR 79278, December 27, 2002; and FDIC Statement of Policy on Bank Merger Transactions,73 FR 8871, February 15, 2008, available at *https://www.fdic.gov/regulations/laws/rules/5000-1200.html.* See also Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, section 604(f), 124 Stat. 1376, 1602 (2010) (codified at 12 U.S.C. 1828(c)(5)), available at *https://www.govinfo.gov/app/details/PLAW-111publ203.*

[17] Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions, 87 FR 18740 (published March 31, 2022).

[18] Comments received are available at *https://www.fdic.gov/resources/regulations/federal-register-publications/2022/2022-rfi-rules-regulations-statements-of-policy-regarding-bank-merger-transactions-3064-za31.html.*

ing agencies and the Department of Justice on an interagency review of the bank merger application process.

Evaluating the Risk of Crypto Assets to the Banking System

The recent growth in the crypto asset industry has corresponded with an increasing interest on the part of some banks to engage in crypto asset activities.[19] Crypto assets bring with them novel and complex risks that, like the risks associated with the innovative products in the early 2000s, are difficult to fully assess, especially with the market's eagerness to move quickly into these products.

The recently published digital asset report by the FSOC describes crypto assets as private sector digital assets that depend primarily on the use of cryptography and distributed ledger or similar technologies.[20] Crypto assets such as Bitcoin are not backed by physical assets, but rather they purport to establish value by their scarcity or utility. As such, the value of these crypto assets at any point is driven in large part by market sentiment. This has resulted in a highly volatile marketplace.

While the FDIC had been generally aware of the rising interest in crypto asset related activities through its normal supervision process, as this interest has accelerated, it became clear that more information was needed to better understand the risks associated with these activities as well as which banks have been engaging in, or are interested in engaging in, crypto asset related activities.

To address that gap, the FDIC issued a Financial Institution Letter (FIL) in April of this year asking the banks the FDIC supervises to notify the FDIC if they are engaging in, or planning to engage in, crypto asset related activities.[21] If so, we asked banks to provide us enough details to allow us to work with them to assess the safety and soundness, consumer protection, and BSA/AML risks associated with the activities and the appropriateness of their proposed governance and risk management processes associated with the activity. The other Federal banking agencies have issued similar requests to their supervised institutions.[22]

Once the FDIC develops a better understanding of activities planned or already active, we will provide the institution with case-specific supervisory feedback.[23] As the FDIC and the other Federal banking agencies develop a better collective understanding of the risks associated with these activities, we expect to provide broader industry guidance on an interagency basis.

These risks of crypto assets are very real. After the bankruptcies of crypto asset platforms that have occurred this year, there have been numerous news stories of consumers who have been unable to access their funds or savings.[24]

The FDIC will continue to work with our supervised banks to ensure that any crypto-asset-related activities that they engage in are permissible banking activities that can be conducted in a safe and sound manner and in compliance with existing laws and regulations. If so, we will work with banks to ensure that they have put in place appropriate measures and controls to identify and manage risks and can ensure compliance with all relevant laws, including those related to anti-money laundering and consumer protection and we will do this in collaboration with our fellow banking agencies.

In addition, crypto firms have used false and misleading statements concerning the availability of Federal deposit insurance for their crypto products in violation

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[19] "The Impact of COVID–19 on Cryptocurrency Markets: A Network Analysis Based on Mutual Information", available at *https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0259869.*

[20] Financial Stability Oversight Council Report on Digital Asset Financial Stability Risks and Regulation 2022, available at *https://home.treasury.gov/system/files/261/FSOC-Digital-Assets-Report-2022.pdf.*

[21] Federal Deposit Insurance Corporation, Financial Institution Letter 16-2022: Notification of Engaging in Crypto-Related Activities, FDIC (April 7, 2022) available at *https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html.*

[22] See OCC, Interpretive Letter 1179 (November 18, 2021); Federal Reserve SR 22-6 / CA 22-6: Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations (August 16, 2022).

[23] Notifications under the FIL and knowledge of engagement or potential engagement that we learn through the supervisory process is confidential supervisory information, but we are aware of approximately 80 FDIC-supervised institutions that are engaging in or are interested in engaging in crypto asset activities, and approximately two dozen that appear to be actively engaged in activities described in the FIL. The FDIC is providing various types of supervisory feedback, depending upon the activity involved, the status of the activity (active or planned), and the institution's risk management framework, among other things.

[24] See, *https://www.washingtonpost.com/business/2022/07/06/voyager-bankruptcy-three-arrows/, https://www.washingtonpost.com/business/2022/07/13/crypto-bankruptcy-celsius-depositors/.*

of the law. In response, the FDIC issued letters demanding that the firms cease and desist from using misleading statements with regard to deposit insurance.[25] The FDIC also issued an Advisory in July of this year reminding insured banks of the risks that could arise related to misrepresentations of deposit insurance by crypto-asset companies.[26]

One closely related issue that has been a focus of policymakers both at the agencies and the Congress is stablecoins. As investors traded in and out of various crypto assets, a desire arose for a crypto asset with a stable value that would allow investors to transfer value from one crypto asset into another without the need for converting into and out of fiat currencies. This gave rise to the development of various so-called stablecoins.

Unlike Bitcoin and similar crypto assets, most stablecoins are represented as backed by a pool of assets or utilize other methods to help maintain a stable value. Currently, the most prominent stablecoins are purported to be backed by financial assets such as currencies, U.S. Treasury securities, or commercial paper.

Thus far stablecoins have predominantly been used as a vehicle to buy and sell crypto assets for investment and trading purposes—there has been no demonstration so far of their value in terms of the broader payments system. However, the distributed ledger technology upon which they are built may prove to have meaningful applications and public utility within the payments system. This raises a host of important policy questions that will be the subject of careful attention by all of the Federal financial regulators.

Finalizing the Basel III Capital Rules

After the global financial crisis of 2008, the FDIC, OCC and Federal Reserve sought to strengthen the banking system through changes to the regulatory capital framework. This work has been based largely on two sets of standards issued by the Basel Committee on Banking Supervision (BCBS), known as Basel III.[27] The agencies' initial revisions in 2013 included an increase in the overall quality and quantity of capital. The agencies are now turning to the second set of BCBS standards to finalize the implementation of Basel III.

On September 9, the three agencies reaffirmed their commitment to implementing enhanced regulatory capital requirements that align with the final set of Basel III standards issued by the BCBS.[28] These standards, issued by the BCBS in 2017, include ways to strengthen capital requirements for market risk exposures, improve the capital requirement for financial derivatives, and simplify the measurement of operational risk for regulatory capital purposes.

The agencies plan to seek public input on the new capital standards for large banking organizations and are currently developing a joint proposed rule for issuance as soon as possible. Importantly, community banks, which are subject to different capital requirements, would not be impacted by the proposal, given their limited overall size and trading activities.

Supporting Minority Depository Institutions and Community Development Financial Institutions

The preservation and promotion of MDIs remains a long-standing priority for the FDIC.[29] The FDIC's research study, *Minority Depository Institutions: Structure, Performance, and Social Impact*,[30] found that FDIC-insured MDIs have played a vital role in providing mortgage credit, small business lending, and other banking services to minority and low- and moderate-income communities. Similarly, banks des-

[25] See "FDIC and Federal Reserve Board Issue Letter Demanding Voyager Digital Cease and Desist From Making False or Misleading Representations of Deposit Insurance Status", July 28, 2022, available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20220728a.htm* and "FDIC Issues Cease and Desist Letters to Five Companies for Making Crypto-Related False or Misleading Representations About Deposit Insurance", August 19, 2022, available at *https://www.fdic.gov/news/press-releases/2022/pr22060.html.*

[26] See Advisory to FDIC-Insured Institutions Regarding Deposit Insurance and Dealings with Crypto Companies, FIL-35-2022 (July 29, 2022), available at *https://www.fdic.gov/news/financial-institution-letters/2022/fil22035.html.*

[27] See Basel III, International Framework for Banks, available at *https://www.bis.org/bcbs/basel3.htm.*

[28] See FDIC Press Release, PR-65-2022, Agencies Reaffirm Commitment to Basel III Standards (September 9, 2022) available at *https://www.fdic.gov/news/press-releases/2022/pr22065.html.*

[29] See Section 308 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, title III, §308. Aug 9, 1989, as amended by Pub. L. 11-203, title III, §367(4), July 21, 201, 124 Stat. 1556, codified at 12 U.S.C. 1463 note.

[30] See FDIC, Minority Depository Institutions: Structure, Performance, and Social Impact, available at *https://www.fdic.gov/regulations/resources/minority/2019-mdi-study/full.pdf.*

ignated as CDFIs by the Treasury's CDFI Fund provide financial services in low-income communities and to individuals and businesses that have traditionally lacked access to credit.

MDIs and CDFIs are anchor institutions in their communities and play a key role in building a more inclusive financial system. The FDIC supervises approximately two-thirds of the approximately 280 FDIC-insured MDIs and CDFIs. In addition to its supervisory activities, the FDIC's Office of Minority and Community Development Banking supports the agency's ongoing strategic and direct engagement with MDIs and CDFIs.

In support of its statutory requirement to encourage the creation of new MDIs, this past May the FDIC issued a FIL that outlines the process by which FDIC-supervised institutions or applicants for deposit insurance can make a request to be designated as an MDI.[31]

In 2021, the FDIC designated five new institutions as MDIs, and, to date in 2022, one new FDIC-supervised de novo MDI opened for business. Three other existing institutions have been designated as MDIs, and the FDIC approved a conditional application for deposit insurance for a de novo MDI that is now raising capital.

Since 2020, significant new sources of private and public funding have become available to support FDIC-insured MDIs and CDFIs, known collectively as mission-driven banks. The FDIC issued a publication, *Investing in the Future of Mission-Driven Banks: A Guide To Facilitating New Partnerships*,[32] to connect those who wished to support and partner with these institutions. Numerous large banks, technology companies, and others have invested hundreds of millions of dollars into mission-driven banks over the past 2 years. The FDIC also initiated the creation of the Mission-Driven Bank Fund, a private investment fund that will invest in FDIC-insured MDIs and CDFIs.[33] We understand that the anchor investors, Truist Financial Corporation and Microsoft, are poised to select the fund manager in the coming weeks.

The Federal Government has provided new funding to these institutions through nearly $8.3 billion in the U.S. Treasury's Emergency Capital Investment Program (ECIP) and up to $3 billion in CDFI Fund programs, including up to $1.2 billion set aside for minority lending institutions. The banking agencies issued new regulations that revised capital rules to provide that Treasury's investments under the program qualify as regulatory capital of insured MDIs and CDFIs and holding companies.[34] The FDIC developed a Capital Estimator Tool and a Regulatory Capital Guide to enable mission-driven banks to approximate the impact of additional capital on various capital ratios. At the request of mission-driven banks, the FDIC developed a technical assistance program to help ECIP recipients understand supervisory expectations for the significant new growth that this capital will support over the coming years.

The FDIC also benefits from a number of MDI and CDFI bank executives serving on its Advisory Committee on Community Banking (CBAC), the MDI Subcommittee of the CBAC, and the Advisory Committee on Economic Inclusion. These bankers bring the voices of mission-driven banks to the FDIC board and senior executives, and they have provided input on important policy initiatives.

Diversity, Equity, Inclusion, and Accessibility Priorities of the FDIC

Fostering diversity, equity, inclusion, and accessibility (DEIA) continues to be a top priority for the FDIC.[35] Our goal is to have a workforce that is talented, diverse, and committed to fostering a safe, fair, and inclusive workplace and banking system. The agency is focusing on three strategic areas in 2022: (1) implementing strategic initiatives focused on the workplace; (2) Hispanic recruitment and retention, an area identified as needing special attention by an analysis of our employment data; and (3) financial institution diversity.

[31] FDIC Financial Institution Letter, FIL-24-2022, Minority Depository Institution (MDI) Designation (May 19, 2022) available at *https://www.fdic.gov/news/financial-institution-letters/2022/fil22024.html.*

[32] See FDIC, "Investing in the Future of Mission-Driven Banks: A Guide To Facilitating New Partnerships", available at *https://www.fdic.gov/regulations/resources/minority/mission-driven/guide.html.*

[33] See FDIC, Mission-Driven Bank Fund webpage, available at *https://www.fdic.gov/regulations/resources/minority/mission-driven/index.html.*

[34] See FDIC, "Federal Bank Regulators Issue Rule Supporting Treasury's Investments in Minority Depository Institutions and Community Development Financial Institutions", available at *https://www.fdic.gov/news/press-releases/2021/pr21018.html.*

[35] The agency's corporate strategy is outlined in the FDIC Diversity, Equity and Inclusion; 2021–2023 Strategic Plan, available at *https://www.fdic.gov/about/diversity/pdf/dei2021.pdf.*

Workplace Initiatives

A diverse and inclusive workforce, reflecting a variety of experiences and perspectives, is central to accomplishing the mission of the FDIC. Promoting DEIA within the FDIC workforce and the broader financial industry is a key priority for 2022, and was established as one of the seven FDIC Performance Goals.[36] Recruitment and hiring diversity initiatives, support for first-generation professionals and career development programs for the next generation of leaders are among several other employee initiatives.

The FDIC has worked to engage employees at all levels across the agency in strategic initiatives. The Diversity and Inclusion Executive Advisory Council (EAC), comprised of the FDIC's most senior leaders, meets monthly to discuss DEIA matters. Regional Directors discuss DEIA strategies with regional and field office employees. Each month a representative from a diverse identity employee resource group meets with the EAC to share perspectives. In addition, I meet regularly with employee resource groups.

Over recent years, the FDIC has made progress toward improving the diversity of its workforce to better reflect the demographics of the civilian labor force (CLF). The percentage of women hired into entry-level examiner positions, the agency's largest occupational group, increased to 41 percent. In 2021, minority representation at the executive level increased to 23 percent and minority representation across all management levels increased to 24 percent. Persons with disabilities increased to 13 percent of the workforce, above the 12 percent Federal benchmark. Veterans increased to 9 percent of the workforce with veterans representing almost 13 percent of new hires in fiscal year 2021.

One area where the FDIC is placing increased emphasis toward improving diversity is with individuals who self-identify as Hispanic. At less than 5 percent, Hispanic representation is well below the CLF percentage of almost 10 percent based on 2010 census data. By contrast, the agency's workforce who identify as American Indian/Alaska Native, Asian, Black/African American, or Native Hawaiian/Pacific Islander exceeds the CLF.

In an effort to improve the agency's representation with this part of the workforce, the FDIC established an executive level task force to address challenges for Hispanic recruitment and retention. While the agency is focusing efforts to reach individuals that identify as Hispanic, the FDIC will continue recruiting strategically to reach all available talent in the labor market, providing upward mobility opportunities to current employees, and supporting employee engagement at all levels.

Financial Institution Diversity

Since 2016, the FDIC's Financial Institution Diversity Self-Assessment (Diversity Self-Assessment) program has supported the efforts of supervised institutions to create and grow their diversity programs, which allow them to build strong relationships with their clients and communities, maximize workforce representation, and develop and implement inclusion efforts. The FDIC developed the diversity self-assessment framework based on the Joint Standards for Assessing our Regulated Entities' Diversity Policies and Practices that were established with five other Federal agencies.[37] To increase awareness of the agency's Financial Institution Diversity Program, in 2021 the FDIC expanded its outreach with banking organizations and individual banks and launched a social media campaign. For the 2021 reporting period, 172 or 22 percent of 774 FDIC supervised banks with 100 or more employees submitted their Diversity Self-Assessments. This represented a 16 percent increase over 2020 submissions.

Cybersecurity

Threats from malicious cyber actors continue to be a significant and evolving risk for banks and their service providers. Evaluating cybersecurity practices continues to be a high-priority focus of the FDIC's supervision program. In its 2022 Report on Cybersecurity and Resilience,[38] the FDIC highlighted several components of our cybersecurity program including our relevant safety and soundness standards, periodic guidance, alerts and advisories, technical assistance, and other outreach efforts. The report also discussed the agency's efforts to enhance the cybersecurity education

[36] See *FDIC 2022 Annual Performance Plan*, p. 92.

[37] See "Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies", 80 FR 33016 (June 10, 2015).

[38] See FDIC, "2022 Report on Cybersecurity and Resilience", available at *https://www.fdic.gov/regulations/resources/cybersecurity/2022-cybersecurity-financial-system-resilience-report.pdf.*

of our examination force and the creation of examiner work programs related to particular threats. Our report also highlights interagency work related to cyberthreats.

The FDIC recently examined the ransomware attacks against FDIC-supervised institutions and their service providers to learn about the techniques that were most helpful in defending against those attacks. Our examination of ransomware attacks suggests significant vulnerabilities exist. While we did not discover new categories of controls that need to be communicated to financial institutions, our examinations did reveal that those institutions that dedicate resources to implement appropriate controls can effectively defend against these attacks.

The FDIC is now piloting technical examination aids that will help our examiners focus on the controls we found to be most effective in defending against these attacks. Examples of effective controls include high quality multifactor authentication to control access to systems and network segmentation to limit the ability of a malicious actor to move laterally in a network. Where we find these controls to be missing, our feedback and a bank or service provider's response could make a big difference in the company's cybersecurity effectiveness.

Of course, ransomware is one threat among many. We continue to highlight the value of banks and service providers staying aware of the range of threats and vulnerabilities by using the services of entities like the Financial Services Information Sharing and Analysis Center, the U.S. Department of the Treasury, the Federal Bureau of Investigation, and the Cybersecurity and Infrastructure Security Agency. The FDIC will also periodically amplify messages from the intelligence, law enforcement, and other security agencies regarding threats and vulnerabilities that appear particularly critical and actionable.

The FDIC's Pandemic Response and Current Operations of the FDIC

When the FDIC instituted mandatory telework in response to the pandemic on March 13, 2020, the agency could not have imagined that it would be 2½ years before we returned. The FDIC was fortunate, however, in that the foundations for conducting offsite bank examination operations were laid in 2016. Based on work begun in 2017, the FDIC began testing offsite review processes in early 2018. Staff continued to test new tools, and by year-end 2019, we had increased the percentage of safety and soundness examination work completed offsite to 47 percent, an increase from the 2016 level of 32 percent.

The FDIC operated under mandatory telework until this past April, when we moved to the second phase of our Return to the Office Plan, or maximum telework. During this period, staff were permitted, but not required, to return to the office. On September 6, 2022, the FDIC was able to move to Phase 3 of its Return to the Office Plan. This hybrid work environment expanded flexibilities to all FDIC staff that were offered to our examination staff prepandemic, allowing staff to work from home when they did not need to be at a financial institution or in the office.

The FDIC conducted a limited number of in-person examination activities over the past 2½ years. In the current Phase 3 of operations, we have returned to having an in-person component for each safety and soundness and consumer compliance examination. In this hybrid work environment not every examination team member may work onsite at the bank. Some may work from the field office or from home. In designing this new approach, the FDIC drew from lessons learned from our work during mandatory and maximum telework as well as through internal reviews and consideration of responses to a request for information from the banking industry.

Conclusion

In conclusion, the banking industry enters this period of significant economic uncertainty and downside risk in a relatively strong position. It is well-capitalized, has ample liquidity, good credit quality, and is continuing to experience strong loan growth. In its supervisory work, the FDIC will be focused on asset exposures of the banks that could be vulnerabilities in an economic downturn, such as commercial real estate, and interest rate risk in a rising interest rate environment, including unrealized losses on investment securities held by banks.

The FDIC will also be focused on key policy initiatives on CRA, the financial risk of climate change, a review of the bank merger process, crypto asset related financial risks, the Basel III capital rules, and maintaining a strong DIF in compliance with statutory requirements.

In addition, the FDIC will continue its work on other key priorities including supporting MDIs and CDFIs; fostering diversity, equity, inclusion, and accessibility in its workforce; addressing cybersecurity risk at FDIC-supervised institutions; and managing the FDIC's return to the office.

PREPARED STATEMENT OF MICHAEL J. HSU

ACTING COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

NOVEMBER 15, 2022

Introduction

Chairman Brown, Ranking Member Toomey, and Members of the Committee,* I am pleased to testify today before the Senate Committee on Banking, Housing, and Urban Affairs. I will provide an update on the activities underway at the Office of the Comptroller of the Currency (OCC) as we seek to ensure that national banks and Federal savings associations operate in a safe, sound, and fair manner.

The OCC charters, supervises, and regulates nearly 1,100 national banks, Federal savings associations and foreign branches (collectively, "banks") that range in size from very small community banks to the largest, most globally active banks operating in the United States. The vast majority of the institutions we supervise (over 780) have less than $1 billion in assets, while 54 have greater than $10 billion in assets. Together, OCC-supervised financial institutions hold $15.2 trillion in assets-almost 65 percent of all the assets held in commercial U.S. banks.

As Acting Comptroller, I have a responsibility to address issues facing the OCC and the Federal banking system. Our mission is to ensure that national banks and Federal savings associations operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. To meet this mission, last year I identified four priorities for the agency: (1) guarding against complacency by banks, (2) reducing inequality in banking, (3) adapting to digitalization, and (4) managing climate-related financial risks.

I am pleased with the progress the OCC has made to advance these priorities and will provide an update on each in my testimony below. I will also discuss our efforts to promote the long-term health and viability of the community banks and minority depository institutions (MDIs) that the agency supervises.

(1) Guarding Against Complacency by Banks

The Federal banking system remains healthy, despite challenges from the pandemic, current geopolitical events, and rising interest rates. Bank financial conditions and capital levels have been sound for several years and bank liquidity levels have been strong, supporting increases in loan demand, especially in consumer lending. The uncertain economic outlook, however, highlights the importance of not becoming complacent. Vigilance, especially with regards to risk management, is required. For instance, elevated interest rates are leading to unrealized losses on banks' investment portfolios. Although this development does not impact regulatory capital levels for most banks, it warrants careful monitoring. In addition, while credit risk in aggregate remains modest, we are starting to hear about deteriorating credit performance for certain segments. In this environment, proactive risk management, including stress testing at large banks and preparedness for a slowing economy, can help ensure that banks remain strong and able to meet the credit needs of their customers through a range of scenarios.

The OCC also remains mindful of the risks associated with IT operations and cybersecurity, and we have encouraged banks to stay abreast of new technology and threats. Banks need to make appropriate investments to guard against these risks notwithstanding the temptation to postpone updating legacy IT systems or to defer maintenance of existing technology.

Finally, and as I have said previously, we should update the framework for analyzing mergers under the Bank Merger Act.[1] Bank mergers should serve communities, support financial stability and industry resilience, enhance competition, and enable diversity and dynamism within the banking industry. The OCC considers each merger application on its merits and determines whether the proposed transactions meet the statutory and regulatory criteria. At the same time, we need to ensure that these criteria are applied in a manner that does not lead to the formation of a new class of too-big-to-fail banks.

I was pleased to support the recent Advance Notice of Proposed Rulemaking (ANPR) issued by the Federal Deposit Insurance Corporation (FDIC) and the Board of Governors of the Federal Reserve System (FRB) on resolution-related resource requirements for large banking organizations. The joint ANPR represents a concrete step in addressing large banks' financial stability and competition issues. Reevalu-

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

[1] See: Acting Comptroller of the Currency Michael J. Hsu Remarks at Brookings on Bank Mergers and Industry Resiliency, May 9, 2022 (occ.gov).

ating the resolvability risks and requirements for these firms will help to mitigate the risks they may pose to the financial system and the communities they serve.

The OCC is also working closely with our Federal banking agency peers and the Department of Justice (DOJ) to review bank merger frameworks consistent with the President's Executive order on promoting competition. The OCC recently announced a public symposium on bank mergers to take place next February that will invite discussion among thought leaders, academics, community groups, and the banking industry on factors such as competition, financial stability, and community impact.

Banks that remain vigilant and guard against complacency in these and other areas will promote a safe, sound, and fair banking system that continues to support the individuals, communities, and businesses they serve.

(2) Reducing Inequality in Banking

Persistent economic inequality can erode trust in the banking system. Americans who lack access to traditional financial products and services or feel exploited by banks may conclude that the system is working against them, rather than for them. The OCC is focused on several initiatives to address this problem.

The OCC, FRB, and FDIC are working together to modernize and strengthen the Community Reinvestment Act (CRA). The recent interagency notice of proposed rulemaking builds on the history of the CRA as critical to motivating bank lending and investment to help meet the credit needs of low- and moderate-income individuals, families, and communities. The proposal also aims to adjust to changes in the banking industry, including internet and mobile banking. The agencies received hundreds of detailed and thoughtful comments on the NPR, including from Members of this Committee, and we are working together to quickly and thoughtfully consider the suggestions.

The OCC continues to support the removal of structural barriers to financial inclusion through Project REACh, or the Roundtable for Economic Access and Change. Through Project REACh, the OCC convenes leaders from banking, business, technology, and civil rights organizations to reduce specific barriers that prevent full, equal, and fair participation in the Nation's economy by all consumers. Project REACh's work is divided into four national workstreams addressing (1) affordable homeownership, (2) inclusion for credit invisibles, (3) revitalization of minority depository institutions, and (4) access to capital for small and minority-owned businesses. Significant progress has been made and in July we celebrated the program's second anniversary with a national symposium and discussions that provided progress reports regarding each workstream. Recognizing the local nature of barriers to inclusion, several REACh initiatives have been launched to focus efforts on individual communities, including Los Angeles, Dallas, Washington, DC, Detroit, and Milwaukee.

The OCC also is pleased to be a member of the Property Appraisal and Valuation Equity (PAVE) task force sponsored by the Department of Housing and Urban Development (HUD) to address discrimination in appraisals. The OCC supports the actions recommended by the Task Force to ensure greater Federal oversight and effective monitoring for discrimination in residential property appraisals and technology-based valuation. We are enhancing our supervisory methods for identifying discrimination in appraisals, taking steps to ensure that consumers know of their rights regarding appraisals, and supporting research that may lead to new ways to address the undervaluation of housing in communities of color caused by decades of discrimination.

This year, the OCC began efforts to focus on measuring and improving the financial health of consumers. This outcomes-based approach should help in the evaluation of consumer banking products and services, and in addressing inequality and barriers to financial inclusion. In April, the OCC launched a video series entitled "Financial Health: Vital Signs", which includes interviews and panel discussions with leading voices to raise awareness of opportunities for the industry and other stakeholders to take action to increase support for consumer financial health.

In addressing inequality, it is important to recognize that it is expensive to be poor. Overdrafts can be part of that expense. I have been encouraging banks to improve their overdraft programs with their customers' financial health in mind.[2] As noted in a June 21, 2022, PEW Research article, the largest U.S. banks have made changes to their overdraft policies that could save consumers more than $4 billion

[2] See: "Don't Be the Last Banker To Update Your Overdraft Program", *American Banker*, March 28, 2022.

annually.[3] The savings are coming from banks lowering penalty fees for overdrafts, reducing the daily maximum number of overdraft fees that are charged, adding a grace period or buffer amount before fees kick in, or eliminating nonsufficient funds fees or overdraft transfer fees. Changes at the largest national banks could save consumers billions of dollars annually.[4] The OCC has observed significant decreases in overdraft fee revenue in 2022 at the large banks we supervise which should have outsized benefits for Black and Hispanic customers who, as the June PEW article notes, are more likely to incur overdrafts. I am optimistic that the positive changes made by these large banks are inspiring more banks to make similar pro-consumer changes to their overdraft programs. For instance, community banks with outsized revenue from overdrafts have also begun to reform their overdraft programs in ways that are pro-consumer and reduce each bank's reliance on such fees.

Additionally, the OCC continues to strengthen its supervision processes and enhance its resources devoted to compliance with fair lending laws. For example, the OCC updated its annual process for screening bank retail lending activities to provide a more targeted fair lending examination strategy and to better deploy resources to identify weaknesses or wrongdoing. If the OCC's fair lending examinations find evidence of a potential pattern or practice of discrimination, the OCC makes referrals to the DOJ and/or HUD, as required by law. In October 2021, the OCC reaffirmed its obligation to refer potential fair lending violations to the DOJ and share our extensive examiner, economist, and legal findings to ensure a unified and unmitigated focus on the supervision and enforcement of fair lending laws.[5] It is not acceptable that redlining and other forms of lending discrimination continue in the year 2022, and the OCC will not hesitate to take enforcement action if necessary.

Within the banking industry specifically, there is opportunity to improve upon diversity and inclusion at every level—from the board rooms to leadership teams to employees. Diversity of background and thought will make these institutions stronger, fairer, and more representative of their communities. Data would help banks, regulators, and the public recognize improvements and benefits. Currently, banks may voluntarily report diversity data to the Federal banking regulators although less than 20 percent of banks choose to do so. Increasing participation in this reporting would provide greater visibility into the diversity of the banking industry and identify where banks can make better progress.

The OCC is also doing its part to improve our own diversity and inclusion. Over the past 10 years, the OCC's total minority workforce has become more reflective of the country as a whole, and manager and senior-level manager positions held by minorities and women also have increased.[6] While this trend is positive it is clear that more needs to be done.

Additionally, the OCC has nine employee network groups,[7] administered by our Office of Minority and Women Inclusion, to support diversity and inclusion throughout the agency by sponsoring programs to help attract, develop, and retain the best talent regardless of race, national origin, gender, physical abilities, or age. These groups help to attract and retain employees from diverse backgrounds and to create an inclusive work environment that promotes a sense of belonging. In addition, in furtherance of our support of military members and their families, the agency is now a partner with the Department of Defense Military Spouse Employment Partnership (MSEP) which is an initiative around targeted recruitment and employment.

For the fourth consecutive summer, the OCC hosted its High School Scholars Internship Program (HSSIP), a 6-week paid internship for minority students from public and charter high schools in the District of Columbia. This program provides an opportunity for students to explore a variety of career paths at the OCC, gain

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[3] See: "Large Banks Improve Overdraft Policies and Cut Fees", The Pew Charitable Trusts (pewtrusts.org).

[4] "America's Largest Banks Make Major Overdraft Changes That Will Help Consumers", The Pew Charitable Trusts (pewtrusts.org).

[5] Remarks by Acting Comptroller Michael J. Hsu at the Department of Justice, Combatting Redlining Initiative Announcement (occ.gov), Oct. 22, 2021.

[6] The OCC's minority population has increased from 30 to 36 percent. Manager positions held by minority and female populations increased from 21 to 28 percent and 37 to 39 percent respectively. Senior level manager positions held by minority and female employees increased from 20 to 25 percent and 27 to 30 percent respectively. The Executive Committee of the agency is now 50 percent female and 50 percent non-White.

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

an understanding of the financial services industry, and engage in enrichment activities on financial literacy and leadership fundamentals. Since its inception, the program has expanded beyond the OCC and now includes interns at the Federal Housing Finance Agency, the Securities and Exchange Commission, and the National Credit Union Administration. In addition to our HSSIP program, the OCC has provided minority college students with paid internship opportunities for more than a decade through its National Diversity Internship Program.

(3) Adapting to Digitalization.

Like many industries, the business of banking is becoming increasingly digitalized. This is occurring as technology firms expand into financial services and, to a lesser degree, via developments with cryptocurrencies. While cryptocurrency matters have received the most visibility over the past year, especially recently, I believe that financial technology generally, and fintech and big technology companies specifically, will warrant much more of our attention going forward.

Increasingly, retail banking is being conducted online and through mobile phones. Similar to other industries, financial services that were integrated and contained within the banking industry are being compartmentalized and offered by a greater number of entities, including technology firms. Digitalization has put a premium on online and mobile engagement, customer acquisition, customization, big data, fraud detection, artificial intelligence, machine learning, and cloud management. As a result, bank-fintech partnerships have grown exponentially and become more complicated, driving changes to banks' risk profiles.

The OCC has adjusted its bank information technology (BIT) examinations in response to these technological innovations. Today, these examinations include assessments of ransomware, artificial intelligence, cloud computing, and distributed ledger technology. In addition, the OCC is focused on ensuring banks have an effective risk management framework in place for fintech partnerships generally and, more specifically, digitalization. Currently, a majority of our supervisory concerns relate to fundamental elements of risk management, e.g., board oversight, governance, and internal controls. Common issues involve insufficient information security controls, change management issues, particularly with emerging products and services, and IT operational resilience.

Our recently released 5-year Strategic Plan[8] also acknowledges the increase in digitalization and the need to be agile and credible in addressing them. We are building on the excellent work of staff over the last 5 years in the fintech/crypto space with regards to policy and service providers and related to IT and operational resilience supervision. We are also working closely with our interagency peers and engaged in ongoing dialogue to help ensure that we have a shared understanding of how the financial system is evolving and to minimize opportunities for regulatory arbitrage and races to the bottom.

Much more work remains. My sense is that we are still in the early stages of a significant shift in how banking services will be provided in the future. Last month, I announced the creation of the Office of Financial Technology, which will be established in 2023. This new office will help ensure the OCC continues to be a leader in developing expertise in financial technology and the financial technology landscape. It will expand upon the significant work and considerable successes of the OCC's Office of Innovation, which was established in 2016 to coordinate the agency's efforts around responsible innovation. By expanding our aperture, engaging more substantively with nonbank technology firms, and mapping out bank-fintech relationships and risks, we can help ensure that banking remains trusted and safe, sound, and fair as the system evolves.

In addition, the OCC has adopted a "careful and cautious" approach to crypto in the Federal banking system. This is reflected in Interpretive Letter 1179,[9] which establishes guardrails to clarify that the institutions we supervise should not engage in certain crypto activities unless they demonstrate that the activities can be performed in a safe, sound, and fair manner. This approach has proven to be prudent following the Terra stablecoin collapse in May and more recently with the bankruptcy of FTX. Despite contagion across cryptocurrencies and several crypto platforms, the federally regulated banking system has, for the most part, been largely unaffected.

(4) Managing Climate-Related Risk to the Federal Banking System

The OCC's focus on climate-related financial risk is firmly rooted in our mandate to ensure that national banks operate in a safe and sound manner. It is not our

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[8] See: "OCC Releases Strategic Plan for Fiscal Years 2023–2027", OCC.
[9] See: Interpretive Letter 1179 (occ.gov).

role to tell bankers what customers or legal businesses they may or may not have as customers. We do not pick winners or losers. Rather, we are committed to staying in our safety and soundness lane, which means focusing on banks' risk management of climate-related financial risks, not on setting industrial policy.

Climate-related financial risks pose novel challenges to traditional risk management. We have taken several steps to build our expertise and capacity to meet those challenges. Shortly after my appointment, the OCC joined the Network for the Greening of the Financial System and established a Climate Risk Officer position at the agency to focus on these issues.

In December, we issued for comment Principles for Climate-Related Financial Risk Management for Large Banks. The draft principles focus on the climate-related risk management capabilities of large banks, i.e., those with at least $100 billion in consolidated assets. Our focus on large banks is intentional, as that is where the risks are most complex and material. We are continuing to consider the comments and working with our interagency colleagues to determine the next steps in this area.

Community banks have expressed concern about the scope of our climate risk-related efforts. I have made a concerted effort to meet with community bankers and have traveled across the country to listen to them and hear from them directly about their communities and experiences handling acute weather events. I believe that earning their trust on this issue is vitally important. As such, I am committed to continued dialogue and constructive engagement with all stakeholders, including community bankers, as we build our climate risk management expertise.

(5) The OCC Supports Community Banks and MDIs

Overseeing the safety and soundness of community banks is central to the mission of the OCC. The OCC is committed to fostering an environment that allows well-managed community banks to grow and thrive. In particular, we are taking specific actions to support community banks in five areas: (1) revitalizing minority depository institutions (MDIs), (2) reducing bank assessments, (3) promoting de novos, and (4) tailoring regulation based on size and complexity.

Revitalizing of Minority Depository Institutions—MDIs are on the front lines of serving low-income, minority, rural, and other underserved communities and are a critical source of credit for them. However, MDIs have fallen in number and, until recently, faced challenges with accessing capital, adopting new technology, and modernizing their infrastructures. In July, the OCC issued an updated policy statement on MDIs [10] that reaffirms the agency's commitment to these institutions and describes the range of programs in place to support MDIs. The policy statement serves to focus the agency's efforts to ensure MDIs remain a bedrock of financial access and inclusion.

The OCC's Project REACh has helped to expand relationships between larger banks and MDIs through capital investments dedicated to improving the technological infrastructure of MDIs. Since 2020, 26 banks signed Project REACh's pledge to support MDIs [11] to provide dedicated technical assistance for MDI staff talent development, diversification of product offerings, and nearly $500 million in investments to MDIs.

Reducing Bank Assessments—Effective March 2023, the OCC will make a 40 percent reduction in assessments for a bank's first $200 million in assets and a 20 percent reduction for bank assets between $200 million and $20 billion. This recalibration will result in a $41.3 million reduction in assessments for community banks. We are hopeful that this reduction will provide community banks with extra capacity to invest and seize opportunities related to digitalization, compliance, cybersecurity, and personnel.

Promoting De Novo—A healthy community bank industry needs a pipeline of new entrants and start-ups. The OCC was pleased to charter a de novo community bank minority depository institution in Houston, Texas, in May of this year. This was the first de novo MDI that the OCC has chartered since before the financial crisis and a welcome addition to the Houston communities it will serve. The OCC is also actively engaged with our Mutual Savings Association Advisory Committee to understand the impediments to the chartering and formation of de novo mutual savings associations.

Regulation Based on Size and Complexity—It is imperative that regulatory expectations for banks are differentiated based on their size and complexity. We are mindful of concerns from community bankers that requirements for large banks

[10] See: "OCC Updates Policy Statement on Minority Depository Institutions", OCC.

[11] See: "Project REACh Pledge Released To Promote Vitality of Minority Depository Institutions", OCC.

should not trickle down to smaller banks as such requirements can be excessive and tie up scarce personnel and other resources. The OCC will remain diligent in guarding against such outcomes. Direct engagement with each community bank that we supervise, and our two Federal Advisory Committees: The Minority Depository Institution Advisory Committee and the Mutual Savings Association Advisory Committee will continue to assist in this effort.

Conclusion

I am committed to ensuring that OCC-supervised banks operate in a safe, sound, and fair manner, meet the credit needs of their communities, treat all customers fairly, and comply with laws and regulations. As we work to ensure that the Federal banking system remains a source of strength to the U.S. economy, we will continue to advance key agency priorities to ensure the Federal banking system is well positioned to respond to community and consumer needs well into the future.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Chairman Sherrod Brown:</u>

1. **Your testimony highlighted a number of risks for the banking system. To prepare for these risks, banks need strong capital so that they can continue to lend and serve their customers in a downturn. While the largest institutions in the industry claim that stronger capital requirements reduce lending, we saw in 2020 that even while banks were receiving government support, they used their supposedly scarce capital to pay dividends and buyback their stock.**

   How do strong capital requirements protect the banking and credit union system and how do they ultimately better protect working Americans? What are your agencies doing to achieve this goal?

Capital requirements support the financial system, as well as the American public, in multiple ways. Strong levels of capital help enable banks to absorb losses, to support the economy, and to continue lending to households and business during economic downturns. At the Federal Reserve Board (Board), we are undertaking a holistic review of the capital framework with the goal of supporting the resilience of the financial system under a range of economic conditions. Because history has demonstrated the deep costs to society when bank capital requirements are inadequate, it is important that we ensure capital requirements are calibrated appropriately.

It is critical that we propose and implement the Basel III endgame reforms, which will better reflect trading and operational risks in our measure of banks' capital needs.

2. **In well-designed regulatory capital framework includes risk-based requirements and a leverage ratio "back-up." The supplementary leverage ratio (SLR) is that back-up – protecting against emerging risks not yet included in the risk-based framework, and against the potential for unexpected losses to be underestimated.**

   a. **Do you agree, that the risk insensitive SLR is necessary, and most effective when it includes all of the bank's assets?**

   b. **Some fear that including Treasury securities, held on bank balance sheets, in the SLR may lead to problems in Treasury markets. Given the Federal Reserve's standing repurchase agreement facilities and the Inter-Agency Working Group on Treasury Market Surveillance's progress at making the U.S. Treasury market more resilient, is this still a concern? Please explain.**

Leverage capital requirements, including the supplementary leverage ratio (SLR), serve an important role in our capital framework—specifically, as a credible backstop and complement to our risk-based capital requirements. We are in the process of looking at our capital requirements, including the SLR, to assess how they are supporting the resilience of the financial system, individually and in combination. As part of this review, we are exploring the empirical evidence and examining whether adjustments to the leverage ratio might be appropriate in the context of our holistic review of the capital framework, as well as in context of broader reforms

being undertaken by the Federal Reserve and other agencies. In addition, as a member of the Inter-Agency Working Group on Treasury Market Surveillance, we are working on a multi-pronged approach towards ensuring a well-functioning Treasury market. The Federal Reserve will analyze the impact of any changes to our capital rules on the overall quantity of required capital and the associated benefits and costs to help inform our decision-making.

3. **Industry consolidation and concentration harms local communities. President Biden has called for a plan to strengthen bank merger guidelines in his Executive Order on Competition. The Fed and the OCC recently approved a megamerger resulting in the 7th largest bank in the United States and are currently reviewing another one, but at the same time, the Fed, FDIC, and OCC have raised concerns about domestic, systemically important banks. What is your plan to strengthen the bank merger guidelines and to look at these mega mergers more closely to ensure they work for Main Street?**

Mergers are a feature of vibrant industries, but any potential advantages of a merger must be weighed against the risks the merger could pose to competition, consumers, and financial stability. The Federal Reserve evaluates each proposed bank merger under the statutory factors established by Congress.

The Federal Reserve works closely with the Department of Justice and the federal banking agencies, as appropriate, to analyze the potential competitive effects of proposed bank merger transactions in the geographic markets where the merging firms compete. Where appropriate, the Federal Reserve also consults with other federal banking agencies in evaluating whether the merger would meet the convenience and needs of the communities to be served by the combined firm.

We are currently analyzing our bank merger framework to determine whether any adjustments would be appropriate, with a particular focus on potential changes to how we analyze proposed acquisitions' effects on financial stability, competition for banking products and services, and the combined firm's ability to meet the convenience and needs of the communities it serves. While we are not yet in a position to share specifics on the changes we are considering, this issue remains a priority.

4. **Please describe the range of risks and potential impacts on the economy posed by climate change, and discuss what is being done to coordinate these matters among international regulators. When did the Federal Reserve join the Network for Greening the Financial System (NGFS)?**

The Board became a member of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) on December 15, 2020, following a period of participating in an observer capacity.

Physical and transition risk drivers associated with climate change may affect households, communities, businesses, and governments through damages to property, shifts in business activity, or changes in the values of assets and liabilities. These effects could manifest as traditional prudential risks to banking organizations, including credit, market, operational, and

liquidity risk. To enhance the ability of supervisors and firms to measure and manage climate-related financial risks, on January 17, 2023, the Board announced the launch of a pilot climate scenario exercise involving the nation's six largest banks.

We are also engaging with a wide range of external stakeholders, including with other central banks and supervisory authorities, to better understand the potential impact of physical and transition risks on supervised institutions and on financial stability. In addition to our engagement with the NGFS, Federal Reserve staff participate in working groups established by the Basel Committee on Banking Supervision and the Financial Stability Board. We recognize the benefit of engaging with other regulatory agencies, central banks, and international bodies on these important issues while taking into account the differences across jurisdictions and our own important but narrow domestic mandate.

5. **Financial regulators, like the Federal Reserve, play a significant role in our economy. The Fed, in securing maximum employment and price stability, needs independence from political interference and that is why independent funding is so crucial. A Federal Reserve that has to come to Congress for funding while it conducts monetary policy would no longer be independent. Independent funding helps ensure that decisions impacting the American economy are made outside political headwinds. Vice Chair Barr, has the Federal Reserve's independent funding structure allowed the Federal Reserve to carry out its dual mandate?**

Yes. The Federal Reserve's independence is central to our ability to effectively carry out our dual mandate, and our funding structure is core essential for this independence. Experience from around the world has shown that countries with independent central banks have better economic outcomes. The Federal Reserve's independent funding structure helps ensure we can make monetary policy decisions based on what is good for the economy in the long run rather than shorter-term political considerations.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Ranking Member Patrick J. Toomey:

1. **During the hearing on November 15, 2022, you stated that it would be "useful for [the banking agencies] to provide guidance to the banking sector about how to safely custody crypto assets." In July 2020, however, the Office of the Comptroller of the Currency (OCC) issued guidance stating that national banks may provide custody services for crypto assets.[1]**

   Do you agree with the OCC's analysis? If not, please explain whether you believe national banks may provide custody services for crypto assets and whether you believe that providing custody services for crypto assets differs from any other assets for which banks provide safekeeping and custody services.

   [1] https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf.

Banks have a long history of providing custody services for various kinds of assets and of managing the risks associated with those custody services. While many of the risk management considerations that apply to custody of traditional assets are equally relevant to crypto-asset custody, crypto assets also pose novel risks, including operational risks associated with cryptographic key management, and various compliance risks, particularly in the area of illicit finance. Banks proposing to provide crypto asset custody services need to demonstrate an ability to manage these risks.

As the chartering authority and federal prudential regulator for national banks, the Office of the Comptroller of the Currency (OCC) has the authority to determine what activities are legally permissible for national banks to conduct. The OCC determined in Interpretive Letter 1170 that it is legally permissible for national banks to provide crypto-asset custody services.

2. **Earlier this year, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin 121 (SAB 121), which provides that crypto assets held in custody should be treated as on-balance sheet assets.[2] It has been reported that the SEC staff "did not consult with the banking regulators" before issuing SAB 121.[3] This staff guidance is posing significant challenges for crypto custody by banks, which are subject to capital and liquidity requirements based on their balance sheet assets.**

   [2] https://www.sec.gov/oca/staff-accounting-bulletin-121.
   [3] https://www.reuters.com/technology/us-secs-crypto-guidelines-push-up-costs-lenders-disrupting-projects-2022-09-16/.

   a. **Do you believe that the SEC staff guidance is appropriate? Please explain.**

The Federal Reserve is not responsible for the general accounting policy for public companies, and therefore we are not in a position to comment on such guidance.

b. Are you aware of any other assets held in custody that are treated as on-balance sheet assets under U.S. generally accepted accounting principles (GAAP)?

I am not aware of any other material assets held in custody that are treated as on-balance sheet assets for accounting purposes.

c. Have the banking agencies ever allowed regulated banks to depart from GAAP for purposes of bank regulations? If so, please describe those circumstances.

While the regulatory capital rule generally aligns with generally accepted accounting principles (GAAP), there are some exceptions, including the transitional arrangements for GAAP's current expected credit loss framework and adjustments for accumulated other comprehensive income. Some of these exceptions have been introduced to help banking organization better manage volatility in their capital requirements.

3. On November 23, 2021, the Federal Reserve Board (Fed), the Federal Deposit Insurance Corporation (FDIC), and the OCC issued a statement describing their crypto-asset policy sprint initiative and next steps.[4] The statement noted that, throughout 2022, the agencies plan to provide "greater clarity on whether certain activities related to crypto-assets conducted by banking organizations are legally permissible,' including the issuance and distribution of stablecoins. Although the Fed, FDIC, and OCC have not provided further guidance on bank-issued stablecoins, a recent paper asserts that issuing stablecoins "clearly fall[s] within the existing legal authority of banks to conduct the business of banking."[5]

[4] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.
[5] https://www.theclearinghouse.org/paymens-systems/Articles/2022/11/11082022_Stablecoin-related_Activities.

a. In your view, is it legally permissible for Fed-regulated banks to issue stablecoins?

b. If not, how do you distinguish stablecoin issuance from this activity?

Stablecoins can vary widely in their design and use cases. The Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), and the OCC continue to assess the permissibility of tokens issued by regulated banks, with attention toward the various characteristics that may be important for a permissibility analysis. Of course, a key part of establishing whether a bank can issue a token is determining whether the token can be offered in a manner consistent with safety and soundness and in compliance with all laws and regulations, including those related to illicit finance.

4. On November 16, 2022, the U.S. Department of the Treasury released a report entitled *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets*.[6] Among other things, the report recommends that federal

banking regulators "engage with supervised institutions that are seeking to prudently implement new credit underwriting approaches-including those using alternative data analytics to inform credit decisions" in order to increase competition in consumer credit underwriting. Often, insured depository institutions (IDIs), particularly small and mid-sized IDIs, turn to fintech partnerships to develop and implement innovative consumer underwriting approaches.

[6] https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

a. How have you helped small IDIs build responsible partnerships that offer wider access to credit through underwriting innovation?

b. In light of the Treasury report, what additional steps will you take to expand responsible fintech partnerships that innovating in the underwriting space?

In 2021, the Federal Reserve released two resources focused on relationships between small banks and fintechs. The Federal Reserve Board (Board), along with the OCC, and the FDIC, published a guide to help community banks assess the risks when considering relationships with fintech companies. The guide is intended to be a resource for community banks to use as they conduct due diligence on prospective fintech partners.[1]

The Federal Reserve also published a paper on the evolving landscape of community bank partnerships with fintech companies in 2021.[2] The paper is intended to serve as a resource for both community banks and fintech companies by providing insights gathered from broad outreach efforts and describing different types of community bank-fintech partnerships and key considerations for engaging in them.

In addition, in December 2019, the Board joined the FDIC, OCC, the Consumer Financial Protection Bureau, and the National Credit Union Administration in issuing a joint statement on using alternative data in credit underwriting, after determining that a statement would offer transparency and consistency in how the agencies are approaching these important and rapidly evolving issues.[3] The statement shared agency perspectives on the potential consumer risks and benefits from the use of alternative data in credit underwriting, but did not impose any new obligations or create new expectations for banks or fintechs on the use of alternative data.

To increase access to information, in 2019, the Board dedicated a section of its website specifically focused on responsible innovation, which includes various resources from research

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[1] *See* Board of Governors of the Federal Reserve System, "Conducting Due Diligence on Financial Technology Firms: A Guide for Community Banks" (Washington: Board of Governors, August 2021), https://www.federalreserve.gov/publications/conducting-due-diligence-on-financial-technology-firms.htm.

[2] *See* Board of Governors of the Federal Reserve System, "Community Bank Access to Innovation through Partnerships," September 2021), https://www.federalreserve.gov/publications/files/community-bank-access-to-innovation-through-partnerships-202109.pdf.

[3] *See* Board of Governors of the Federal Reserve System, Consumer Affairs Letters, CA 19-11: Interagency Statement on the Use of Alternative Data in Credit Underwriting, December 12, 2019.

to engagement to help inform banks and companies of the Federal Reserve's outreach and perspectives related to emerging financial technologies.[4]

In 2021, the Board joined the FDIC and OCC in issuing proposed guidance on sound risk management principles for banking organizations when developing and implementing risk management practices for all stages in the life cycle of third-party relationships. The agencies are in the process of finalizing that guidance. The guidance will provide insured depository institutions with principles for establishing responsible partnerships with fintechs that seek to innovate in the underwriting space.

[4] *See* Board of Governors of the Federal Reserve System, About the Fed, Innovation at https://www.federalreserve.gov/aboutthefed/innovation.htm.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Jon Tester:

1. **During the hearing, we discussed your agencies' proposed changes to the Community Reinvestment Act, and how they would incorporate the unique needs of rural communities and Indian Country into their proposal.**

   How will you evaluate success of those changes?

   One of the greatest challenges I hear about in communities across Montana, and most places across the country, is the availability of housing people can afford – there just isn't enough.

The availability of affordable housing is an acute problem in many areas of the country, including in rural communities and Indian Country. I believe that the revised Community Reinvestment Act regulations proposed by the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation offer an opportunity to provide more clarity on the requirements for banks to address these needs in different ways, including by making qualifying mortgage loans and by engaging in community development activity to increase the supply of affordable rental and single-family housing. I have provided additional information below on how the agencies' CRA proposal sought to further this objective. The agencies have evaluated the comments provided by external stakeholders in response to the proposal and we are working to address this feedback as we develop a CRA final rule.

As to how the agencies would evaluate success of the proposed changes, I expect that the Federal Reserve Board and the other agencies would conduct ongoing quantitative assessments of how the revised regulations are affecting bank lending and investment to address affordable housing and other needs in rural communities and Indian Country, among other locations. We would also work closely with the Federal Reserve Banks and their local stakeholder networks to gather feedback on the impact of the changes on these communities.

Additional information on how the agencies' proposed CRA regulations sought to address affordable housing needs in rural communities and Indian Country:

- ***Strengthening and clarifying evaluation of retail lending***: With respect to evaluating bank retail lending, including mortgage loans, the proposal asked for feedback on a set of proposed retail lending metrics, benchmarks, and thresholds tailored to local conditions, reflecting different opportunities and markets in urban and rural counties. The retail lending metrics are intended to clarify what banks need to do to get a Satisfactory or better performance in providing mortgage loans to low- and moderate-income communities, including in rural communities.
- ***Ensuring evaluation of activities outside of branch locations***: The agencies proposed to more effectively and comprehensively evaluate both retail and community development activity occurring outside of branch-based assessment areas to address credit deserts and

hot spots. This is particularly important in rural and tribal areas where there may be few bank branches.

- ***Clarifying Community development financing***: With respect to community development financing, the agencies sought feedback on proposed metrics and benchmarks that would support a more consistent evaluation of bank community development loans and investments in both rural and urban areas, tailored to local conditions. These loans and investment are an important source of financing for affordable rental housing. The agencies also proposed a set of impact review factors to provide more clarity on how banks could get additional qualitative credit for community development activities with a high level of impact and responsiveness, including in rural geographies and in tribal areas.
- ***Clarifying qualifying community development activities in rural communities and Indian Country***: To help encourage bank funding of community and economic development needs in rural and tribal communities, the agencies proposed more clarity on qualified activities in these areas. The proposal included a new community development definition for *Activities in Native Land Areas* to recognize the unique status of Native and tribal communities and help address the specific community development needs in these communities. It also proposed providing additional certainty that activities with Community Development Financial Institutions will qualify for CRA consideration and proposed greater clarity to banks on receiving credit for activities with Minority Depository Institutions. By providing more clarity and increased flexibility on these eligible activities, the proposal addressed feedback from a range of stakeholders regarding eliminating barriers to additional bank investment in these areas.

2. How would these CRA changes effect housing supply?

As I noted previously, the NPR included a number of provisions to support bank loans and investments to create new or renovate existing affordable housing. In particular, these provisions to evaluate bank community development financing are intended to provide clarity on how banks will be evaluated for their community development loan and investments, including in rural communities. The proposal also asked for feedback on providing clearer standards on what qualifies as naturally occurring affordable housing.

I am committed to carefully reviewing views expressed by commenters on increasing the supply of affordable housing and ensuring that a revised regulation has the appropriate clarity and incentives to support this objective.

3. Cybersecurity isn't a new challenge, but it's certainly a growing problem. There are more robust requirements for financial institutions around data security than many industries, but we've still seen problems in recent years.

It's clear that we need to be doing more to address these threats, whether through coordination, actions from you all and other regulators and agencies, the private sector, or additional work from us here in Congress. Much of that intersects with your work.

How can you as regulators better help the institutions you regulate protect themselves from cybersecurity threats? Especially smaller community financial institutions

What more should we be doing to address threats to cybersecurity?

The Federal Reserve recognizes the increasing and evolving nature of cybersecurity threats to the financial system, and views cybersecurity as one of its highest priorities.

The Federal Reserve's supervision and regulation of financial institutions encompasses review and monitoring of institutions' cybersecurity risk management and information technology programs. As part of its safety and soundness supervision, the Federal Reserve issues cybersecurity-related regulations and guidance, examines and monitors supervised institutions' cybersecurity risk management posture, and collects data on cyber incidents (along with the other banking agencies) to monitor trends in the financial services sector.

Pursuant to the Federal Reserve's authority under the Bank Service Company Act (BSCA), we also examine and monitor certain services performed on behalf of financial institutions by their service providers. The Federal Reserve's supervision activities in this area promote financial institutions', including community banks, ability to protect against cyber incidents and other hazards, safeguard critical infrastructure, and address emerging technology risks.

Financial institutions have made progress on managing these risks in the past few years, though cybersecurity risks continue to evolve. Given geopolitical events, financial institutions have adopted a heightened cybersecurity alert. The Federal Reserve is closely monitoring developments in coordination with other banking agencies. Thus far, there has been no material impact on the financial sector.

Cybersecurity remains a notable issue for community banks, which continue to face cyberattacks. Reliance on third-party service providers and other technology solutions also presents operational risks. Moreover, these banks face challenges in attracting and retaining qualified staff to maintain their cyber risk-management programs.

Earlier this fall, the Federal Reserve, along with other Federal Financial Institutions Examination Council (FFIEC) member agencies, issued an update to the October 2018 Cybersecurity Resource Guide for Financial Institutions.[1] The programs and tools in the guide are designed for, or otherwise available to, financial institutions, including community banks. The purpose of this guide is to help financial institutions meet their security control objectives and be prepared to respond to cyber incidents. Through the FFIEC, we proactively send cybersecurity alerts and messaging from member agencies and law enforcement to supervised institutions.

Additionally, the Federal Reserve, with the federal banking agencies, recently began requiring banking organizations to notify the agencies of cyber incidents (and a bank service provider to notify affected banking organization customers as soon as possible for certain incidents). This requirement will help the banking agencies become aware of and react to emerging threats before

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[1] *See* the FFIEC *Cybersecurity Resource Guide for Financial Institutions,* September 2022, https://www.ffiec.gov/press/pdf/FFIECCybersecurityResourceGuide2022ApprovedRev.pdf.

they become systemic, as well as enable us to provide support to affected institutions, including community banks who may face a greater challenge in responding to such an incident.

The Federal Reserve also actively participates in public-private partnerships, which prove critical in threat monitoring, identifying vulnerabilities, and responding to events across the financial sector. The Federal Reserve also participates in periodic cyber exercises with other regulatory agencies, financial institutions, and trade associations. These exercises have proved useful in advancing public-private responses to operational disruptions in the financial sector.

The Federal Reserve is working to make progress on operational resilience given financial institutions' significant recent challenges from a wide range of disruptive events, including cyber incidents. Such events, combined with financial institutions' growing reliance on third-party service providers, expose them to a range of operational risks across their supply chain that can affect their safety and soundness and potentially lead to systemic risks.

The Federal Reserve intends to continue its work in this area to ensure financial institutions understand and manage these complex and evolving challenges and that consumers remain protected. Additionally, we are committed to working closely with other domestic agencies and international authorities to ensure that supervisory approaches on operational resilience are well coordinated.

4. **The Federal Reserve's recent efforts to rein in inflation through interest rate hikes have resulted in unrealized losses which have affected community banks' tangible book values but not their regulatory capital levels. The Federal Housing Finance Agency's policy on tangible capital—which is inconsistent with the federal banking regulators—limit access to Federal Home Loan Bank advances to banks that have negative tangible book values even though they are considered "well capitalized" by the regulatory agencies.**

   What steps are the regulators taking to ensure that reasonable investments that community banks made in US Treasuries that have resulted in unrealized losses do not become a supervisory crisis?

   Are regulators taking steps to work with banks that are impacted? Is there a regulatory process in place so that a bank can seek a waiver from the FHFA's tangible capital rule?

   Have the regulators engaged with FHFA to prevent this from becoming a liquidity issue that further puts pressure on the already fragile housing market?

As you note, the Federal Housing Finance Agency (FHFA) has oversight responsibility for the Federal Home Loan Banks (FHLB) System. My job, as a federal banking regulator, been focused on the safety and soundness of the banks within the Federal Reserve's purview.

We have been reaching out to state member banks reporting significant unrealized securities losses to discuss the composition of their investments, the stability of their deposits and other

funding sources, and any steps bank management is taking to enhance liquidity sources or reposition investments. During these discussions we are making sure that bank management is aware of FHLB lending restrictions tied to tangible equity positions and, as appropriate, are encouraging bank management to take additional steps to mitigate potential risks by updating liquidity contingency plans, testing availability of non-deposit sources of funding, and considering steps to retain and build capital.

Internally, we refreshed examiner training on interest rate risk to ensure examiners are up to date on longstanding interagency supervisory expectations for interest rate risk management and that they take a careful approach to evaluating each bank's particular situation. We also are meeting regularly with colleagues from the other federal banking agencies to coordinate supervisory approaches. Going forward, we are increasing outreach and communication to the industry on interest rate risk, sharing prudent risk management practices and reminding banks of existing guidance. As appropriate and on a case-by-case basis, we are also conducting targeted reviews tailored to each bank's facts and circumstances to update supervisory assessments.

5. **I think that the pandemic really showed that our bipartisan *Economic Growth, Regulatory Relief, and Consumer Protection Act* struck the right balance.**

   During the pandemic we saw financial institutions able to step up and serve their communities, with the balance sheets and protections to withstand the economic crisis that came with it.

   In Montana, our community banks and credit unions stood up to make programs like PPP work for small businesses on their Main Streets and keep folks employed.

   Do you think the banking and credit union sectors you oversee are safe and secure right now?

   Where are there areas that give you concern?

Our banking system is sound and resilient, with strong capital and liquidity. The Federal Reserve, working with the Treasury Department and the Federal Deposit Insurance Corporation (FDIC), took decisive actions to protect the U.S. economy and to strengthen public confidence in our banking system. These actions demonstrate that we are committed to ensuring that all deposits are safe. We will continue to closely monitor conditions in the banking system and are prepared to use all of our tools for any size institution, as needed, to keep the system safe and sound.

While capital and liquidity are strong, recent events have shown that we must evolve our understanding of banking in light of changing technologies and emerging risks. To that end, we are analyzing what recent events have taught us about banking, customer behavior, social media, concentrated and novel business models, rapid growth, deposit runs, interest rate risk, and other factors, and we are considering the implications for how we should be regulating and supervising our financial institutions. And for how we think about financial stability.

As discussed in the November 2022 issuance of the Board's semi-annual *Supervision and Regulation Report*, the banking industry's financial condition has generally remained sound. Problem loan and delinquency rates remain low. Large financial institutions generally remain well capitalized and have adequate liquidity positions, though many of these institutions also have unresolved concerns related to governance and controls. Most community and regional banking organizations are in stable financial condition. Nearly all community and regional banking organizations are rated satisfactory or stronger.

However, the Federal Reserve is closely monitoring financial and non-financial risks. Financial risks include falling values of investment securities, interest rate risk, liquidity risk, credit deterioration, and concentrations of certain credit categories. Non-financial risks include cybersecurity, operational, third-party risk management, and other technology-related risks.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Catherine Cortez Masto:

1. **Why does the Federal Reserve count the equity investment and the leveraged loan toward the Public Welfare Investment cap, despite the fact that leverage loans are non-recourse debt which poses no risk to financial institutions?**

2. **Why does the Federal Reserve treat leveraged loans differently from the other regulators in assessing the PWI cap?**

3. **How does this broad assessment of the cap affect the use of New Markets Tax Credits?**

4. **Will the Federal Reserve reconsider this assessment of Public Welfare Investments?**

State member banks often finance public welfare investments (PWIs), including those eligible for New Market Tax Credits (NMTCs),[1] using equity investments by the bank and nonrecourse loans from an unaffiliated party (leverage loans). Because banks are subject to statutory limits on their aggregate PWIs, counting leverage loans against a bank's aggregate investment limit can reduce an individual bank's capacity to make PWIs, and the market's ability overall to maximize the use of NMTCs.

Federal Reserve Board (Board) staff recently conducted an in-depth review of this issue to ensure that the capacity of state member banks to make PWIs is not being limited unnecessarily. A number of factors were considered in this process, including, among other things, the structure, terms, and riskiness of the investments and loans. As a result of this review, we have issued updated guidance clarifying that state member banks may exclude leverage loans from their aggregate PWI amount for certain transactions involving NMTCs and similar tax credits, thus increasing their capacity to make PWIs. This updated guidance can be found in the Board's Frequently Asked Questions about Regulation H.[2]

5. **How are you applying the Uniform Appraisal Dataset created through the President's PAVE taskforce to enhance your efforts to ensure fairness in the residential housing market?**

The Federal Reserve remains committed to its collaboration with our interagency partners to execute on the Property Appraisal and Valuation Equity (PAVE) Action Plan that focuses on identifying concrete actions to eliminate bias and advance equity in home appraisals. The Uniform Appraisal Dataset, which standardizes appraisal information collected by Fannie Mae and Freddie Mac, is an important tool in furthering the goals of the PAVE taskforce. The Federal Reserve is working closely with the Federal Housing Finance Agency to obtain access to the dataset. When we obtain such access, we intend to use the data to inform our research in this area and our supervision of entities within our jurisdiction.

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[1] 26 U.S.C. § 45D.

[2] *See* https://www.federalreserve.gov/supervisionreg/legalinterpretations/reg-h-frequently-asked-questions.htm.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Tina Smith:</u>

1. **When reviewing bank mergers, how does the Fed weigh and address the risk consolidation poses to banking access, particularly for rural, low-income, and minority communities?**

As I mentioned in my recent testimony, at the forefront of my mind is the importance of maintaining the strength and diversity of banks of all sizes that serve communities across the country.

In reviewing merger and acquisition (M&A) proposals under the Bank Holding Company Act of 1956, the Bank Merger Act, and the Home Owners' Loan Act, the Federal Reserve evaluates each of the statutory factors, including the convenience and needs of the communities to be served. In evaluating the convenience and needs factor, the Federal Reserve considers, among other things, whether the relevant institutions are helping to meet the credit needs of the communities they serve, and are providing access to banking products and services that meet the needs of customers and communities. Additionally, the Federal Reserve considers the potential impact of branch closures, consolidations, and relocations expected to occur in connection with the proposal, and the proposed programs, products and activities to be offered by the combined institution. Proposals not meeting the convenience and needs factor, or any of the other statutory factors, generally would not be approved.

Physical branches remain important to many financial institutions' ability to meet the credit needs of the local communities in which they operate. When financial institutions combine, the combination has the potential to increase or to reduce consumers' and small businesses' access to available credit and other banking services. Given these potential outcomes, the Federal Reserve analyzes the impact of expected branch closures on the communities to be served, paying particular attention to the effect of such closures on low- and moderate-income (LMI) communities and other communities which may be disproportionately impacted by branch closures.

As part of the M&A application process, holding companies and insured depository institutions are required to provide a list of all existing branches of the applicant or target that will be closed or consolidated as a result of the proposal, to the extent such information is available, and to indicate the effect on the branch customers served, and to identify any branches to be closed that are located in LMI geographies.[1] In cases where an applicant has not determined which branches will be closed, the applicant is expected to provide information regarding its branch closure policies and procedures, how it will identify branches to be closed, and what steps the applicant will take to mitigate the impact of branch closures on the applicant's entire community, including LMI neighborhoods.

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[1] *See* Information Requirement No. 20 to Instructions to Federal Reserve Form FR Y-3, Application to Become a Bank Holding Company and/or Acquire an Additional Bank or Bank Holding Company, at https://www.federalreserve.gov/reportforms/forms/FR_Y-320180731_i.pdf.
Also see Information Requirement No. 14 to General Information and Instructions to Federal Reserve Form FR 2070, Interagency Bank Merger Act Application, at https://www.federalreserve.gov/reportforms/forms/FR_207020210608_f.pdf.

Specifically, the Federal Reserve considers the following factors with respect to proposed branch closures and their potential impact on the communities to be served:

- The number of branches to be closed and how many are located in LMI areas, and whether these are disproportionate relative to the total number of closures.
- Whether the number of branches to be closed in underserved communities are disproportionate relative to the total number of closures, and whether such closures are likely to have a significant adverse impact on those communities.
- The proximity and accessibility of the branches to be closed to branches that would remain open.
- The steps the applicant plans to take to mitigate the impact of proposed branch closures in LMI areas and other areas likely to be adversely impacted.
- The views of the applicant's primary federal regulator on the proposed closures, including any potential fair lending or CRA implications.
- The institutions' records of opening and closing branches in their most recent CRA and fair lending evaluations.
- Confirmation by the applicant that it will comply with applicable law governing branch closures and with its internal branching policies and procedures.

In addition to branching plans, when evaluating M&A proposals, the Federal Reserve considers the programs, products, and activities, including lending, investments, and services, that help meet community needs to be offered in the combined footprint of the resulting firm; specifically, those programs, products and services geared toward LMI geographies and individuals. Other relevant considerations include the efforts undertaken or contemplated by the applicant to ascertain and address the needs of the communities to be served, including community outreach activities, as a result of the proposal; the anticipated CRA assessment areas of the combined organization; and the plans to administer the CRA and consumer compliance program at the combined organization. This forward-looking analysis plays an important role in the Federal Reserve's overall consideration of an M&A application.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Kyrsten Sinema:</u>

1. **As the Federal Reserve continues to combat inflation by raising interest rates, it is important that with respect to capital requirements, we strike a thoughtful balance that protects the resiliency of the financial system while ensuring capital remains affordable and accessible to families and small businesses. Given that we anticipate interest rates to rise and for elevated U.S. inflation to persist in the near term, has the Fed analyzed the effect that the 2017 changes to Basel III will have on the cost of capital? What opportunities within the Basel framework exist to more accurately align risk weights with the intrinsic credit risk of a firm.**

Setting appropriate capital requirements is vital for the long-run strength of the financial institutions regulated by the Federal Reserve and supports the optimal functioning of the U.S. economy. We are working closely with our counterparts at the other banking agencies on implementing the Basel III reforms on risk weights, which seek to better align regulatory capital requirements with the risks of individual firms. As part of the rulemaking effort, Federal Reserve staff is analyzing the impact of the reforms on the overall quantity of required capital and any associated costs. Such analysis will help inform the regulatory provisions we propose to implement.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Raphael Warnock:</u>

1. **The recent news about FTX underscores the necessity of robust regulation in our financial markets, especially for novel financial instruments like digital assets and cryptocurrencies that have largely operated freely and with impunity. I understand that this industry touches all four of your agencies differently, and jurisdictional lines are still being drawn. Ultimately it is up to Congress to create a stable regulatory environment for the digital asset industry and to define those lines. However, in the meantime, what are your agencies doing to safeguard everyday Americans and the financial system against a crypto-connected crisis, as we saw with FTX?**

Federal Reserve-supervised banking organizations are subject to strong prudential regulation and active supervision with regard to all of their activities, including those related to crypto-assets and the crypto-industry.

On August 16, 2022, the Federal Reserve issued Supervision and Regulation letter SR 22-6/CA 22-6, "Engagement in Crypto-Asset-Related Activities by Federal Reserve-Supervised Banking Organizations," which outlines a process for Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-related activities to notify their supervisors.[1] Those notifications allow the Federal Reserve to take a coordinated and comprehensive approach to the supervision of banking organizations engaging in these activities.

In addition to the notification requirement, the letter reminds Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-asset-related activities that, prior to engaging in such activity, they

- must determine that such activity is legally permissible and determine whether any filings are required under applicable federal or state laws; and
- have in place adequate systems, risk management, and controls to conduct such activities in a safe and sound manner and consistent with all applicable laws, including applicable consumer protection statutes and regulations.

Furthermore, on January 3, 2023, the Federal Reserve Board (Board), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies) issued a joint statement which highlights key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describes the agencies' approaches to supervision in this area. Specifically, the statement highlights several key risks associated with crypto-assets and the crypto-asset sector that banking organizations should be aware of, as demonstrated by the significant volatility and vulnerabilities over the past year. These include risk of fraud and scams, legal uncertainties, inaccurate or misleading representations and disclosures, volatility, runs on stablecoins, interconnectedness amongst crypto-asset participants, inadequate governance and risk management practices, and heightened risks associated with open, public, and/or decentralized networks.

[1] *See* https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm.

The agencies continue to take a careful and cautious approach related to current or proposed crypto-asset-related activities and exposures at each banking organization and continue to assess whether and how those activities can be conducted in a manner that is safe and sound, legally permissible, and in compliance with applicable laws and regulations, including those designed to protect consumers. Federal Reserve staff continue to assess the ongoing risks associated with crypto asset activity in order to inform future policy development and appropriate banking supervision.

2. What have you been doing to educate firms and consumers under your jurisdiction about the risks associated with these entities, especially those operating offshore?

We have endeavored to make sure Federal Reserve-supervised banking organizations, as well as consumers are aware of potential risks arising from digital assets and cryptocurrencies through various supervisory guidance and public outreach channels, including remarks, testimony, and published reports.

In addition, as mentioned above, the Federal Reserve is interacting directly with the banking organizations we oversee to monitor how they are interacting with crypto-assets, and for determining an appropriate supervisory response. Guidance issued by the Board and jointly with the OCC and FDIC on crypto-asset risks to banking organizations include discussions on key risks that can arise from crypto-asset activities and describes the agencies' approaches to supervision.

3. Banking deserts drive everyday Americans to use predatory lending services and other firms that take advantage of the lack of options available in communities. What steps are you taking to ensure that folks that live in banking deserts have access to basic banking services?

Ensuring individuals have access to basic banking services and are included in the financial mainstream is a high priority for the Federal Reserve.

Research indicates that access to bank branches matters: households with a nearby branch are more likely to have a bank account and less likely to use a non-bank transaction product. However, recent research indicates that bank branch closures may have accelerated during the pandemic, and that these closures may have led to the creation of new banking deserts.

One program dedicated to helping ensure access to affordable and low-risk bank or credit union accounts is Bank On.[2] The Federal Reserve has worked with Bank On to expand the availability of online transaction accounts in communities that may lack easy access to safe and affordable deposit accounts. Several Reserve Banks provide technical assistance and stakeholder engagement to statewide and local Bank On coalitions. Notably, the Federal Reserve Bank of St. Louis operates a national reporting platform for all financial institutions offering Bank On accounts, and the collected data helps stakeholders to understand local markets and quantify the program's impact.

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[2] For more information, see Bank On at https://joinbankon.org/.

In addition, access to options for affordable small dollar credit can help consumers bridge cashflow gaps. To provide supervisory clarity and encourage small dollar lending, in May 2020, the Federal Reserve, FDIC, National Credit Union Administration (NCUA), and OCC published the *Interagency Lending Principles for Offering Responsible Small-Dollar Loans* (small-dollar lending statement).[3] The purpose of the small-dollar lending statement is to support and encourage small-dollar lending activities by financial institutions, and to give financial institutions flexibility to structure their programs in a manner that is safe and sound, fair to borrowers, and consistent with all applicable laws and regulations. Advocacy organizations have noted that this guidance was instrumental in large banks beginning to develop affordable small-dollar credit products that stand in opposition to predatory products available from nonbanks.[4] We have also begun to see smaller banks entering this space in partnership with third party vendors.

The Community Reinvestment Act (CRA) is also an important tool to encourage banks to serve their communities, and we are looking at strengthening these as part of our CRA modernization efforts.

4. What are your agencies doing to promote responsible small-dollar lending by the financial institutions you regulate? Please describe how your agencies are measuring the effectiveness of your efforts to date and share supporting data if available.

The Federal Reserve has long encouraged banks to respond to customers' small-dollar credit needs in a responsible manner. These loans can play an important role in helping customers meet unexpected expenses or shortfalls during periods of economic stress. Furthermore, responsible small-dollar loans can facilitate inclusion and the opportunity for improved access to credit. Since 2018, at least six large banks have developed new small-dollar products to respond to the demands of their depositors.

In March 2020, the Federal Reserve, with the Consumer Financial Protection Bureau (CFPB), FDIC, NCUA, and OCC, issued a statement[5] encouraging banks, savings associations, and credit unions to offer responsible small-dollar loans to consumers and small businesses affected by COVID-19. Subsequently, in May 2020, the Federal Reserve, FDIC, NCUA, and OCC published a more in-depth small-dollar lending statement, the details of which are described in my response to Question 3.

5. How will this inflationary period and the role that corporate price gouging has had on inflation guide your decisions surrounding Fed policy in the future?

Price stability is the responsibility of the Federal Reserve, and our policy actions over the past year have reflected our determination to bring inflation back down to 2 percent from its current unacceptably high level. That remains our focus.

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[3] SR 20-14 / CA 20-8: *Interagency Lending Principles for Making Responsible Small-Dollar Loans* (May 20, 2020), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2014.htm.

[4] For example, see Horowitz and Kravitz, "Six of the Eight Largest Banks Now Offer Affordable Small Loans," Pew Trust, February 17, 2023.

[5] SR 20-7/CA 20-5: *Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19* (Mar. 30, 2020), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2007.htm.

Corporate profit margins are high in some sectors. These high margins mainly reflect the combination of strong demand and supply constraints. As supply constraints ease and as demand in the economy moderates, demand and supply should move into better balance, and, correspondingly, we should see profit margins move down to more normal levels.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Mike Rounds:</u>

1. **Since the Federal Reserve stopped its monthly bond purchases and started its quantitative tightening and raising interest rates, both the Fed and the Treasury have warned of decreased liquidity in the Treasury Market. When the market experienced illiquidity in March 2020, the Federal Reserve temporarily removed U.S. Treasuries and deposits held at the Federal Reserve from the SLR. This made it possible for financial institutions to intermediate in Treasury markets, providing much-needed liquidity. As you know, the SLR is meant to be a backstop to risk-weighted capital regulation, but unfortunately, throughout the pandemic, the SLR has become more of a binding constraint for financial institutions, creating fewer incentives for banks to invest in U.S. Treasuries.**

    a. **In your review of the SLR, have you been considering the negative effects the current ratio has on banks' ability to intermediate to provide liquidity to the Treasury market?**

    b. **Additionally, if you were to introduce stricter capital requirements, is the Fed taking into account the harm consumers would ultimately face if financial institutions are forced to sit on excess capital?**

Leverage capital requirements, including the supplementary leverage ratio (SLR), serve an important role in our capital framework—specifically, as a credible backstop and complement to our risk-based capital requirements. We are in the process of looking at our capital requirements, including the SLR, to assess how they are supporting the resilience of the financial system, individually and in combination. We are exploring the empirical evidence about how our capital requirements are working together in the context of the broader reforms undertaken by the Federal Reserve and other agencies in the wake of the global financial crisis. In addition, as a member of the Inter-Agency Working Group on Treasury Market Surveillance, we are working on a multi-pronged approach towards ensuring a well-functioning Treasury market.

The Federal Reserve is committed to robust engagement with the public as part of our rulemaking process, including through the notice and comment process that is required by law.

2. **On September 7, the Federal Reserve, the OCC, and the FDIC jointly reconfirmed plans to implement the final set of Basel III standards in the U.S. The Basel Quantitative Impact Study released in February 2022 demonstrates that these standards will, on average, meaningfully increase minimum capital requirements for all banks. However, you and the other Federal Reserve Governors have said that current capital levels are more than sufficient to meet current economic conditions and stress tested scenarios.**

    a. **Are you concerned that higher capital levels will lead to less lending into the real economy?**

b. Given the fact that banks weathered the COVID pandemic, which functioned like a test of the post-financial crisis reforms, and given the heightened economic uncertainty and volatility of the current inflationary and monetary environment, what impact will further increasing regulatory capital requirements have on the U.S. financial system and the broader economy?

Setting strong capital requirements is vital for the long-run strength of the financial institutions regulated by the Federal Reserve and supports the optimal functioning of the U.S. economy. At the Federal Reserve, we are undertaking a holistic review of the capital framework with the goal of supporting the resilience of the financial system under a range of economic conditions.

Empirical research supports the social benefits of strong capital requirements at banks, particularly when economic conditions weaken. While poorly capitalized banks may be forced to shrink during bad times, better capitalized banks have the capacity to support the economy by continuing to lend to households and businesses through stressful conditions. And to the extent bank capital reduces the frequency or severity of financial crises, the public is much better off with strong capital.

International comparisons also suggest strong capital requirements support banks and the U.S. economy. We have strong capital levels today, and generally higher bank capital requirements in the United States after the Dodd-Frank Act have corresponded with healthy economic growth and have supported the competitiveness of U.S. firms in the global economy

The Federal Reserve is committed to robust engagement with the public as part of our rulemaking process, including through the notice and comment process that is required by law.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Jerry Moran:</u>

1. **In its current form, the Agencies' proposed rule requires banks utilizing Strategic Plans to be assigned new Assessment Areas based upon where specific lending activities already occur, concentrating competition among many lending institutions, including nonbanks, for the same loans and creating the unintended consequence that focused efforts on arbitrarily chosen lending activities, instead of allowing for innovation and creativity in meeting the most critical financial needs of a community. Ultimately, providing loans or community development investments and services only to the most heavily populated areas will divert financial and human capital from less densely populated areas. This outcome is completely contradictory to the goals of serving bank deserts - one of the goals the Agencies claim is a primary focus of CRA modernization. Are the Agencies willing to fix the discrepancies identified above, and preserve the Strategic Plan Option in its current form as part of the final rule, to ensure the current goals and objectives that meet communities' needs and accommodate an individual bank's capabilities due to the superior community benefit the Plan provides and the ability to create innovative investments while promoting regulatory and public engagement? Banks that collaborate under the Strategic Plan with their prudential regulators and community stakeholders to serve those communities as intended under the Act, have achieved great outcomes, and have been recognized by you, their prudential regulators, earning repeated Outstanding CRA ratings.**

The comment period on the interagency Community Reinvestment Act (CRA) Notice of Proposed Rulemaking (NPR) closed on August 5, 2022. The Federal Reserve Board (Board), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies) have benefited from the substantive and thoughtful comment letters received on the proposal. I appreciate the concerns you have raised regarding the proposed strategic plan approach, and see value in having a strategic plan approach that balances flexibility for banks with unique business models and consistency in the evaluation process. I look forward to carefully reviewing this issue and discussing it with my interagency colleagues as we work towards developing a final rule.

2. **The Strategic Plan allows the bank and the regulator to work together if alterations to the plan are required, allowing the bank to optimally serve their communities, especially those that include low- and moderate-income populations, as well as investing in underserved areas like banking deserts, communities the regulators also seek to serve in CRA modernization. Why are the Agencies proposing a one-size-fits-all approach for Strategic Plans that will create a purely formulaic approach to fulfill the requirements of the Community Reinvestment Act, which will deprive some banks of the essential flexibility to meet the unique development needs of many underserved communities in which they operate, and for which the Agencies have historically rewarded creative and innovative CRA approaches to serve those same communities?**

As noted, I appreciate the concerns you have raised on the importance of maintaining flexibility for banks choosing to be evaluated under a strategic plan. I see value in having a strategic plan

approach that balances flexibility for banks with unique business models and consistency in the evaluation process.

3. **The Agencies' efforts to address climate change through financial regulation have significantly increased in recent years. Contrary to research from the Federal Reserve Bank of New York, many regulators assert that the effects of climate change pose an existential risk to banks. While not directly mandating climate-related policies for banks, statements and principles issued by the Agencies seem to heavily insinuate that supervised banks need to incorporate certain efforts against climate change or else be subject to unwanted regulatory attention.**

   a. Will you provide an example of a U.S. financial institution that failed due to climate change?

   b. Given the absence of standardized data reporting on climate risk, how are you confident that the metrics used to measure a bank's climate risk provide an accurate representation?

   c. Will you commit to ensuring that financial institutions with climate-related risk exposure will not be subject to regulatory retaliation until a standardized framework is agreed upon by industry and regulators?

As a prudential supervisor, the Federal Reserve is focused on understanding how to identify, measure, monitor, manage the impacts of potential future shocks on supervised institutions. For example, an increase in the frequency or severity of extreme weather events could contribute to borrowers' financial stress and reduce their ability to repay or service debt. Similarly, an increase in the frequency or severity of extreme weather events could reduce a banking organization's ability to recover fully the value of a loan in the event of default.

Measuring, monitoring, and managing these potential future shocks is a primary objective of the Board's pilot climate scenario analysis exercise. This learning exercise is designed to build capacity for banks and help them develop metrics that more effectively capture their climate-related financial risks. The pilot climate scenario analysis exercise is an exploratory exercise and does not have consequences for bank capital or supervisory implications.

4. **On September 28, Federal Reserve Governor Michelle Bowman said bank merger reform should consider competition from credit unions and nonbank lenders. Governor Bowman asserted, "Credit unions whose field of membership includes all, or almost all, of the market populations, whose branches are easily accessible to the public, who engage in a significant amount of commercial lending and who have staff available for small business services, or who have acquired a community bank should be part of any initial competitive screen." As the credit union industry has grown from 68 million members and assets of $312 billion in 1995 to over 130 million members and assets of more than $2.1 trillion today, do you support research to determine if the current regulatory landscape puts banks at a competitive disadvantage compared to credit unions and nonbank lenders?**

The Federal Reserve is assessing its process for performing merger analyses, such as a more systematic incorporation of competition-related factors, and opportunities for improvement.

As credit unions' have changed, these changes should be reflected in our analysis. The same is true for other nonbank providers.

5. **The Fed and the FDIC are reopening the public debate about the need for new regulatory requirements to support effective resolution of large domestic banks. I've heard that your Advanced Notice of Proposed Rulemaking may imply that these banks' extensive work on resolution plans in recent years could be radically shifted in new directions, despite the agencies' approval of those plans. The agencies note that they want input on the related costs to the industry - how will you assure the public that any new requirements will be cost-effective?**

The Board continuously considers whether potential improvements to its regulatory framework are appropriate to ensure that it functions as intended to encourage safety and soundness, financial stability, and other statutory mandates. The Advance Notice of Proposed Rulemaking on Resolution-Related Resource Requirements for Large Banking Organizations issued by the Board and FDIC seeks public comment on potential new requirements, including a long-term debt requirement, that could improve optionality in resolving a large banking organization or its insured depository institution, and the costs and benefits of such a requirement. The potential burden of any regulatory action is an important consideration and often one of the main topics discussed by public comments that the Board considers in the rulemaking process.

6. **CRA stakeholders-including some community advocates-have raised concerns that the interagency CRA proposal is overly partisan, which could result in a rulemaking that will not stand the test of time. Do you believe the durability of a new regulatory framework is important? What can the agencies do to ensure that a modernized regulation will not fall victim to shifting political winds, a result that would not benefit communities, banks, or regulators?**

Stakeholders have expressed strong support for the banking agencies to work together to modernize the CRA regulatory and supervisory framework. The interagency proposal is an important step forward in building a shared, modernized CRA framework that has broad support.

One way to ensure that a CRA regulatory proposal is durable and balanced is to seek significant external stakeholder feedback. I am pleased that the proposal sought feedback on a wide range of issues and that the agencies received such substantive and thoughtful comments.

As I continue to review the proposal and discuss it with my Board colleagues, I remain committed to the durability of a new regulatory framework.

7. **Many comment letters responding to the interagency CRA proposal expressed concern about the complexity of the proposed Retail Lending Test and its associated performance metrics. Is this a concern that you share? Do you believe that the test and**

its performance metrics would understandable and manageable for community banks-including community banks with assets of only $2 billion that will be considered "large banks" under the proposal?

I agree with the objective of ensuring that regulations are not overly complex. I believe the CRA regulations should address differing community needs and bank business models and sizes. I also see merit in providing additional clarity, consistency, and transparency through a combination of quantitative metrics and qualitative evaluation factors.

8. **According to the preamble to the proposal, 34% of "large" banks (defined as having assets of $2B or more) would fail the Retail Lending Test in their new Retail Lending Assessment Areas. Numerous times, the proposal states that this is "appropriate" but does not explain the agencies' rationale for proposing performance benchmarks that would represent such a significant shift in CRA ratings. Please explain why the agencies believe it is "appropriate" to set the Retail Lending performance measures at a level where 1/3 of banks would receive an Unsatisfactory rating in their Retail Lending Assessment Areas. Follow-up: CRA performance benchmarks should be rigorous, yet achievable, and the expectation should be that all banks can meet or exceed the established standard-as is the case with all other consumer protection and safety and soundness regulations. Do you agree that artificially high benchmarks could incentivize banks to engage in undue risk taking in order to comply with the regulation's performance standards?**

In developing a retail lending metric to provide greater clarity, consistency, and transparency, the agencies proposed threshold levels intended to provide performance expectations for the different Retail Lending Test conclusions. The agencies sought feedback on whether the proposed retail lending metrics and thresholds were appropriate and were set at the appropriate levels.

The agencies are reviewing and considering the comments received on the proposal. I am committed to carefully reviewing your concerns and considering ways to address these issues while staying true to the guiding principles that were articulated in the proposal.

9. **To address the development and proliferation of digital banking, the proposed CRA rule would create new Retail Lending Assessment Areas (RLAA) where a bank makes more than 100 mortgages or 250 small business loans.**

   Have the agencies analyzed where these new assessment areas would be created? If so, can you share that information with us? Note: ABA's preliminary analysis using existing HMDA and CRA data finds that most RLAAs would be located in areas currently well-served by banks, which could add to the problem of hot-spots and not encourage CRA activities in underserved areas.

The interagency proposal sought to adapt to the expanded role of mobile and online banking by updating the approach for where banks are evaluated for their CRA performance. While maintaining a focus on bank branches, the proposal asked for feedback on evaluating large bank

performance in areas where they have a concentration of mortgage or small business lending outside of where they have branches.

The agencies included information in the proposal on the potential effects of different retail lending thresholds on large banks. The agencies asked for feedback on a number of aspects of the retail lending assessment area proposal, including whether a bank should be evaluated for all of its major product lines in each retail lending assessment area and whether there are alternative methods that the agencies should consider for evaluating outside lending that would preserve a bank's obligation to meet the needs of its local communities.

I am committed to carefully reviewing any concerns expressed by commenters and considering ways to address these issues while staying true to the guiding principles that were articulated in the proposal.

10. Cost/benefit analysis: The actual benefit to communities and consumers targeted by CRA should be measured against the substantial increase in regulatory burden. How have the agencies determined that the proposal strikes this balance? Are there less burdensome alternatives that could accomplish this objective?

I see merit in providing additional clarity, consistency, and transparency through a combination of quantitative metrics and qualitative evaluation factors. Providing that additional clarity, consistency, and transparency may require additional data, but data requirements should be focused on high-value outcomes.

As I continue to review the proposal and discuss it with my Board colleagues, I remain committed to reducing data burden where possible while still ensuring that a reformed regulation meets the objectives of the statute.

11. Implementation period: The proposed one-year implementation period following publication of a final rule is too short given the complexity of the proposal and we believe a longer period is necessary. One year is not an adequate amount of time for banks to turn operations over to a new regime of requirements and collect and report the data required for benchmarking and comparisons. Given these significant constraints, will the agencies consider a longer implementation period?

The comments received on the CRA proposal included perspectives on the appropriate implementation period, including some views recommending a longer implementation period. As the agencies continue to review the comments and discuss alternatives to the NPR, we will consider a range of options related to implementation.

12. Performance standards: At a June 6 forum sponsored by the Urban Institute, FDIC Chair Martin Gruenberg said the following: "Raise the bar for performance, meaning, what a bank did before to earn an Outstanding or High Satisfactory will not be sufficient. They will have to engage in more lending activity to earn the recognition. The goal is more lending to more low- to moderate-income communities." Banks already make great efforts to serve their communities through CRA, but Mr. Gruenberg's

statement implies that banks are not doing enough. Why do the agencies believe the bar needs to be raised for CRA performance? A 125% threshold for Outstanding performance will practically eliminate the opportunity for banks with significant market share in any market to achieve an Outstanding rating in that market. How and why were the thresholds established?

In developing a retail lending metric to provide greater clarity, consistency, and transparency, the agencies proposed threshold levels intended to provide performance expectations for the different Retail Lending Test conclusions. The agencies sought feedback on whether the proposed retail lending metrics and thresholds were appropriate and were set at the appropriate levels.

The agencies are reviewing and considering the comments received on the proposal. I am committed to carefully reviewing any concerns expressed by commenters and considering ways to address these issues while staying true to the guiding principles that were articulated in the proposal.

13. Thresholds: While we understand the agencies have given some background to the reasoning for the specific thresholds (p 33919), we believe the proposed mortgage and small business loan thresholds for delineating retail lending-based assessment areas need to be increased or include other modifications. As proposed, many banks would have increased assessment areas far beyond current requirements (e.g., one institution in our membership would have a 700% increase in assessment areas). As a possible unintended consequence, these low thresholds may lead to reduced lending, leaving borrowers with few options.

a. Have the agencies considered the possible consequences of banks pulling out of certain possible assessment areas due to the impracticality of adding additional countywide MSAs due to low volume thresholds?

b. Have the agencies considered alternatives to the proposal including on national out of footprint area?

An important aspect of the interagency proposal is that it sought to adapt to the expanded role of mobile and online banking by updating the approach for where banks are evaluated for their CRA performance. While maintaining a focus on bank branches, the proposal asked for feedback on evaluating large bank performance in areas where they have a concentration of mortgage or small business lending outside of where they have branches.

The agencies included information in the proposal on the potential effects of different retail lending thresholds on large banks. The agencies asked for feedback on a number of aspects of the retail lending assessment area proposal, including whether a bank should be evaluated for all of its major product lines in each retail lending assessment area and whether there are alternative methods that the agencies should consider for evaluating outside lending that would preserve a bank's obligation to meet the needs of its local communities.

I am committed to carefully reviewing any concerns expressed by commenters and considering ways to address these issues while staying true to the guiding principles that were articulated in the proposal.

14. **Retail lending test: Several areas of the proposal do not fully account for the transition of the industry toward digital delivery channels, especially for banks that primarily or exclusively serve customers through digital channels. For example, it is unclear how a digital bank could pass the Retail Services and Products Test given the test's focus on branch distribution. Additionally, the Retail Lending Test is tied to specific geographies, but in practice, digital lending is not related to any specific geography, meaning many digital banks will be scrutinized under the RLT simply because they happened to make 100 mortgage or 250 small business loans in a given geography. Will the agencies consider further tailoring the rule to account for digital banks?**

I appreciate the concerns you have raised regarding the evaluation approach for banks with an online/digital business model, including the proposed focus on branch distribution and the focus on evaluating activities outside of facility-based assessment areas. I see value in having an evaluation approach that seeks to appropriately evaluate banks with unique business models, including banks choosing to be evaluated under a strategic plan. I look forward to carefully reviewing the views expressed by commenters on this issue and discussing it with my Board colleagues as we work towards developing a final rule.

15. **Strategic plans: The strategic plan option in the proposal seems less flexible than under the current CRA framework, and the agencies seem to be backing away from an option they have often asked banks to consider under the current framework. The proposal contains very little information about when a strategic plan might warrant flexibility with respect to the otherwise applicable standards and does not detail the extent of the available flexibility. Since the proposed strategic plan option would not be much different from evaluation under the relevant performance test, will the agencies provide some transparency on how the strategic plan option will maintain flexibility for banks that do not fit into the conventional retail framework, such as digital banks and banks focused on consumer lending?**

As noted previously, I appreciate the concerns you have raised on the importance of maintaining flexibility for banks choosing to be evaluated under a strategic plan. I see value in having a strategic plan approach that seeks to balance flexibility for banks with unique business models and consistency in the evaluation process. I look forward to further reviewing this issue as the agencies continue to move forward in the rulemaking process.

16. **Indirect lending: In an indirect lending scenario, banks have little contact and little discretion targeting LMI borrowers. Have the agencies considered excluding indirect auto loans, or other types of indirect financing including equipment, RV, marine, etc., from the auto lending evaluation?**

I appreciate the concerns you have raised regarding the evaluation approach for banks doing indirect lending. The agencies are reviewing comments received related to which retail lending

products to evaluate. This included some perspectives related to whether automobile lending should be evaluated as a major product line and, if so, what types of lending would be included in that analysis. As the agencies continue to review the comments and discuss alternatives to the NPR, they will consider a range of options related to evaluation of automobile lending and banks with an indirect lending model for these loans.

17. More than half American consumers are finding it difficult to meet emergency financial needs according to a recent GAO study. Over the last decade, there have been 19 regulatory actions pertaining to small dollar lending, many of which have all but killed the small dollar market for depository institutions and pushed consumers to the less regulated and less supervised alternative lending markets like payday lenders. As noted by the GAO, many depository institutions are hesitant to dedicate the resources needed to adequately develop small-dollar products that will help consumers meet their monetary shortcomings.

a. Do you believe there is a need for small dollar loan product offered by highly regulated depository institutions?

The Federal Reserve has long encouraged banks to respond to customers' small-dollar credit needs in a responsible manner. These loans can play an important role in helping customers meet unexpected expenses or shortfalls during periods of economic stress. Furthermore, responsible small-dollar loans can facilitate inclusion and the opportunity for improved access to credit. Since 2018, at least six large banks have developed new small-dollar products to respond to the demands of their depositors.

b. Do you believe it is important for the banking agencies to coordinate small dollar lending policies? What are you doing to facilitate that?

In March 2020, the Federal Reserve, with the Consumer Financial Protection Bureau (CFPB), FDIC, National Credit Union Administration (NCUA), and OCC, issued a statement[1] encouraging banks, savings associations, and credit unions to offer responsible small-dollar loans to consumers and small businesses affected by COVID-19. Subsequently, in May 2020, the Federal Reserve, FDIC, NCUA, and OCC published a more in-depth document, the *Interagency Lending Principles for Offering Responsible Small-Dollar Loans* (Principles).[2] The purpose of the Principles is to support and encourage small-dollar lending activities by financial institutions, and to give financial institutions flexibility to structure their programs in a manner that is safe and sound, fair to borrowers, and consistent with all applicable laws and regulations.

Among other key points, the Principles note that small-dollar loan products may be implemented through effectively managed third-party relationships. Technological innovations and fintech partnerships may make these products less expensive (for both consumers and banks) and may consequently make them more attractive for banks to offer. The Federal Reserve, on its own and

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[1] SR 20-7/CA 20-5: Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19 (Mar. 30, 2020), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2007.htm.

[2] SR 20-14 / CA 20-8: Interagency Lending Principles for Making Responsible Small-Dollar Loans (May 20, 2020), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2014.htm.

with its interagency partners, has published various issuances to aid banks in effectively managing such innovations and partnerships. For example, the Federal Reserve joined an interagency statement on the use of alternative data in consumer credit underwriting.[3] The Federal Reserve also issued a publication[4] and guidance[5] to support banks' understanding and compliance program development.

18. There have been rumors that the CFPB is planning to shift liability for P2P payments that consumers make to a scammer. Obviously, scammers will profit from such a policy because, armed with an official government document, they will be able to induce people to pay them by telling them there is no risk in sending the money -even if the circumstances are suspicious. However, banks, unlike the consumer, would have no insight into the transaction to be able to stop it. Are you concerned about: The impact on bank safety and soundness given banks' inability to identify or stop the fraud and the size of potential fraud losses banks would incur? The impact on competition if small banks in particular cannot offer the product because the risk of loss is too much to bear? The harm to consumers if banks begin charging for these very popular services, limiting access to the product, or adjusting the model to reduce the potential for fraud loss (i.e., imposing delays in consumer access to the money or limiting transaction amounts or the number of transactions), which will reduce the value or appeal of P2P services?

The Federal Reserve is concerned by recent reports of scams and theft on certain payment services. Where we have jurisdiction, we are committed to working with other regulators and the industry to strengthen our collective defenses against evolving fraud threats. The Federal Reserve actively participates in public/private partnerships to enhance cybersecurity and operational risk management, which prove critical in monitoring threats, identifying vulnerabilities, and responding to events across the financial sector.

As part of our supervisory oversight, we assess an institution's ability to identify, manage, and mitigate risk exposures and leverage a variety of tools (such as fraud management, contractual liability limitation, or insurance). Our assessment would be informed by supervised institutions' experience managing risks relating to similar regulations (such as Regulation E, which limits consumers' liability for unauthorized electronic fund transfers).

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[3] CA 19-11: Interagency Statement on the Use of Alternative Data in Credit Underwriting (Dec. 11, 2019), available at: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191203b.htm.

[4] SR 21-15/CA 21-11: Guide for Community Banking Organizations Conducting Due Diligence on Financial Technology Companies (Aug. 27, 2021), available at: https://www.federalreserve.gov/supervisionreg/srletters/sr2115.htm.

[5] SR 21-16 / CA 21-13: Community Bank Access to Innovation through Partnerships (Sept. 9, 2021), available at: https://www.federalreserve.gov/supervisionreg/srletters/SR2116.htm.

<u>Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve System, from Senator Steve Daines:</u>

1. **You recently mentioned that "events in crypto markets have highlighted the risks associated with new asset classes when not accompanied by strong guardrails"**

   [1] https://www.wsj.com/articles/feds-michael-barr-says-crypto-turmoil-highlights-potential-risks-to-financial-system-11668516393.

   a. **Has the Federal Reserve created any policy recommendations creating these "strong guardrails," and if so, what are they?**

   b. **Where is the line between regulation and stifling innovation and what would a policy guideline following this parameter look like?**

The Federal Reserve has a responsibility to ensure that regulation and supervision foster responsible innovations that improve access to financial services, while at the same time safeguarding consumers, financial institutions, and financial stability. As a general matter, we seek to accomplish that by following the principles of "same risk, same regulation," meaning that novel activities that raise risks that are analogous to those of traditional activities should be regulated in a similar manner.

On August 16, 2022, the Federal Reserve issued Supervision and Regulation (SR) letter SR 22-6, which outlines a process for Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-related activities to notify their supervisors.[1] Those notifications allow the Federal Reserve to take a coordinated and comprehensive approach to the supervision of banking organizations engaging in these activities.

In addition to the notification requirement, the letter reminds Federal Reserve-supervised banking organizations engaging or seeking to engage in crypto-asset-related activities that, prior to engaging in such activity, they:

- must determine that such activity is legally permissible and determine whether any filings are required under applicable federal or state laws; and
- have in place adequate systems, risk management, and controls to conduct such activities in a safe and sound manner and consistent with all applicable laws, including applicable consumer protection statutes and regulations.

On January 3, 2023, the Federal Reserve Board (Board), the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency issued a joint statement which highlights key risks for banking organizations associated with crypto-assets and the crypto-asset sector, describes the agencies' approaches to supervision in this area, and reminds all supervised institutions to engage in robust supervisory dialog before engaging in crypto-related activities. Specifically, the statement highlights several key risks associated with crypto-assets and the crypto-asset sector that banking organizations should be aware of, as demonstrated by the

[1] *See* https://www.federalreserve.gov/supervisionreg/srletters/SR2206.htm.

significant volatility and vulnerabilities over the past year. These include risk of fraud and scams, legal uncertainties, inaccurate or misleading representations and disclosures, volatility, runs on stablecoins, interconnectedness amongst crypto-asset participants, inadequate governance and risk management practices, and heightened risks associated with open, public, and/or decentralized networks.

The agencies continue to take a careful and cautious approach related to current or proposed crypto-asset-related activities and exposures at each banking organization and continue to assess whether and how those activities can be conducted in a manner that is safe and sound, legally permissible, and in compliance with applicable laws and regulations, including those designed to protect consumers. We are carefully monitoring all supervised institutions engaged in crypto-related activities, including any commitments made with regard to these activities.

2. **Speaking to the Senate Banking Committee earlier this month, you stated that crypto-market meltdowns, "remind us of the potential for systemic risk if interlinkages develop between the crypto system that exists today and the traditional financial system"[2].**

   [2] https://www.wsj.com/articles/feds-michael-barr-says-crypto-turmoil-highlights-potential-risks-to-financial-system-11668516393?mod=livecoverage_web.

   a. **Does the Federal Reserve view any linkage between crypto markets and traditional financial systems to beneficial?**

We aim to be technology neutral, but rather focused on effective risk management. The Federal Reserve's objective is to create a regulatory environment that allows for productive innovation, while at the same time ensuring there are guardrails in place to adequately protect against risks to consumers, financial institutions, and financial stability. So far, we have seen limited spillovers from recent stress in crypto-asset markets to the banking system. Bank engagement with crypto-asset activities is very limited at this time and the primary ties consist of providing core banking services, particularly deposit accounts, to crypto-companies. Banks may engage in permissible activities that are consistent with safety and soundness. However, recent market events have demonstrated that the crypto-asset sector has highlighted several risks, including those related to market volatility, fraud, theft, illicit financing, and market manipulation.

3. **You described scenario analysis in his written testimony as "the resilience of financial institutions assessed under different hypothetical climate scenarios."**

   a. **What are the metrics used for evaluation of these financial institutions, and following evaluations, how will the Federal Reserve encourage institutions to follow guidelines without restricting financial innovation?**

On January 17, 2023, the Board launched a pilot climate scenario analysis (CSA) exercise with six large banks and published participant instructions on its public website.[2] The pilot exercise is expected to conclude around the end of the year.

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[2] *See* https://www.federalreserve.gov/publications/climate-scenario-analysis-exercise-instructions.htm.

Climate scenario analysis—in which the resilience of financial institutions is reviewed under different climate scenarios—is an emerging risk-management and supervisory tool used to evaluate climate-related financial risks. By considering a range of possible future climate pathways and associated economic and financial developments, scenario analysis can help large banking organizations and supervisors understand climate-related financial risks.

This pilot exercise is an exploratory exercise and will not have consequences for bank capital or supervisory implications. The exercise is designed to help us understand how supervised institutions manage climate-related financial risks and to enhance the ability of both banks and supervisors to identify, measure, monitor, and manage these risks.

The pilot CSA exercise comprises two separate and independent modules: a physical risk module and a transition risk module. For both modules, the Board described forward-looking scenarios, and participants will estimate the effect of these scenarios on a relevant subset of their loan portfolios over a future time horizon. For each loan portfolio, participants will calculate and report to the Board credit risk parameters, such as probability of default, internal risk rating grade and loss given default, as appropriate. Participants will respond to qualitative questions describing their governance, risk-management practices, measurement methodologies, results, and lessons learned from this pilot exercises.

The Board anticipates publishing insights gained from the pilot at an aggregate level, reflecting what has been learned about climate risk management practices and how insights from scenario analysis will help identify potential risks and promote effective risk management practices. No firm-specific information will be released.

4. **At your confirmation hearing, you stated that the Federal Reserve should not allocate credit, and the only purpose of the Fed's climate scenario analysis should be to understand risks.**

    a. **Given the Federal Reserve already found that the GSIBs would have actually benefitted from extreme weather events, is this pilot scenario really necessary?**

As I said at my confirmation hearing, the Federal Reserve should not be in the business of telling financial institutions to lend to a particular sector or not to lend to a particular sector. I stand by that statement.

The Federal Reserve's responsibilities with respect to climate change are important, but narrow. We view climate-related financial risks through the lens of our existing mandates and authorities, particularly those relating to the regulation and supervision of financial institutions and the stability of the broader financial system. From a supervisory perspective, our primary focus is to evaluate whether banks operate in a safe and sound manner and manage all material risks, including those related to climate change. To that end, the purpose of the Federal Reserve's pilot climate scenario analysis exercise is to enhance the ability of supervisors and supervised banking organizations to identify, measure, and manage climate-related financial risks.

Careful and rigorous research also plays an important role in informing the Federal Reserve's work on climate-related financial risks, and the Federal Reserve looks at a wide range of research that explores a variety of approaches and data sources, particularly on complex issues like the financial risks of climate change. The Federal Reserve will continue to approach climate-related financial risks in an analytically rigorous and transparent way.

5. **Will the Federal Reserve's pilot program incorporate the financial risks of an abrupt transition away from fossil fuels without adequate sources of baseload power to meet demand?**

   It seems to me that such a scenario would lead to even more inflation than we are seeing now, and greater financial risks to banks than would be faced under any other scenario.

The Board's pilot climate scenario analysis exercise is designed to enhance the ability of supervisors and supervised banking organizations to identify, measure, and manage climate-related financial risks.

The pilot exercise is exploratory in nature and evaluates the potential impact of climate change on a bank's risk profile across a range of hypothetical scenarios. The pilot exercise considers both physical and transition risk drivers. Physical and transition risk drivers associated with climate change may affect households, communities, businesses, and governments through damages to property, shifts in business activity, or changes in the values of assets and liabilities. These effects could manifest as traditional prudential risks to banking organizations, including credit, market, operational, and liquidity risk. The Board published instructions for the pilot exercise on January 17, 2023.[3]

[3] *See* https://www.federalreserve.gov/publications/climate-scenario-analysis-exercise-instructions.htm.

National Credit Union Administration

United States Senate Committee on Banking, Housing, and Urban Affairs
Hearing on Oversight of Financial Regulators:
A Strong Banking and Credit Union System for Main Street
November 15, 2022

Responses to the Questions for the Record

Questions for The Honorable Todd M. Harper, Chairman, National Credit Union Administration, from Chairman Sherrod Brown:

1. *In your testimony, you highlighted a number of risks on the horizon for the banking system. In order to be prepared for all these risks, banks need strong capital so that they can continue to lend and serve their customers in a downturn. While the largest institutions in the industry claim that stronger capital requirements reduce lending, we saw in 2020 that even while banks were receiving government support, they used their supposedly scarce capital to pay dividends and buyback their stock.*

   Why do strong capital requirements protect the banking and credit union system and how do they ultimately better protect working Americans? What are your agencies doing to achieve this goal?

Response:

Simply put: Capital is king in a crisis. All financial institutions backed by federal share or deposit insurance should hold capital equal to the risks held on their balance sheets. Capital, after all, is the first line of defense against losses. In the event of a complex credit union's failure, the additional capital buffer provided through a robust risk-based framework protects surviving credit unions, their members, and the taxpayers who ultimately guarantee the Share Insurance Fund. Sufficient levels of capital also insulate credit unions from the effects of unexpected adverse developments in their financial condition, reduce the probability of a systemic crisis, and allow credit unions to serve as credit providers during times of stress without government intervention.

To maintain an appropriate capital regime, the NCUA has recently finalized rules clarifying the ability of certain credit unions to issue subordinated debt that will better protect federally insured credit unions, their members, and taxpayers from losses to the Share Insurance Fund. A well-structured regulatory system of subordinated debt additionally has the potential to expand access to financial services for underserved communities.

At the start of 2022, the NCUA also implemented a revised capital adequacy framework, consisting of a risk-based capital ratio and a complex credit union leverage ratio. Eligible complex credit unions may choose to use the simplified complex credit union ratio to comply with the NCUA's risk-based capital requirements. Otherwise, the risk-based capital ratio

applies. The NCUA has defined a complex credit union as a consumer credit union with total assets greater than $500 million.

This updated capital standards advances safety and soundness and the stability of the credit union system. The overarching intent of the revised framework is to reduce the likelihood of high-risk outliers exhausting their capital and causing systemic losses — which, by law, all federally insured credit unions would have to pay for through the Share Insurance Fund. Consistent with the Federal Credit Union Act's requirements, the framework is also comparable to the system in place for community banks.

Finally, the CARES Act incorporated temporary enhancements to the NCUA's Central Liquidity Facility, including allowing corporate credit unions to serve as agents for a subset of their member consumer credit unions. This short-term change allowed corporate credit unions to provide emergency liquidity quickly to their member consumer credit unions with less than $250 million when needed. Previously, the NCUA Board has unanimously requested the extension of this member-agent authority, and the House approved the change in statutory language as part of its version of the FY 2023 Defense Authorization. Unfortunately, the language was not included in the final conference agreement, and related legislation died at the end of the session.

As the new Congress begins its work, the NCUA Board renews its request to reinstate the provision to allow corporate credit unions to serve as an agent to the Central Liquidity Facility for a subset of their members. The higher interest rate environment experienced over the last year is resulting in increased liquidity pressures for credit unions of all sizes, and this legislative change would ensure greater access to liquidity.

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Senator Jon Tester:

Housing:

1. *Is there more that the credit unions you regulate could do to impact housing supply?*

Response:

The lack of safe and affordable housing in this country is a critical problem. Federal credit unions serving rural areas and tribal lands, like those found in Montana, have an opportunity to finance affordable housing. One important source of affordable housing supply is manufactured homes, which are often a more affordable option for households with limited resources. Credit unions with the low-income designation are also uniquely situated to help their membership purchase such homes.

By providing safe, consumer-friendly financing for manufactured homes — including chattel properties — credit unions have facilitated the growth in housing supply and can continue to do so. I am aware of at least one credit union that has specialized in manufactured home lending, and other credit unions serving Native Americans are working to address the unique lending needs associated with homes built on tribal lands.

Credit Union Liquidity:

2. *Given increasing interest rates and the impact that has had in the mortgage industry, and the effects of the pandemic on credit unions' balance sheets, many have expressed concern about liquidity in the coming quarters.*

Response:

We have in recent months seen a rise in liquidity risk at credit unions of all sizes, including those above $1 billion in assets, and we are closely monitoring these developments through the supervision process.

Efforts to improve the quality and actionability of contingency funding plans have also been a part of the NCUA's strategic focus in recent years. While the disintermediation of credit union deposit rates versus short-term market rates continues, outflows through the third quarter of 2022 have been modest. We are seeing pressures in the brokered deposit, participation, and funding markets. Stress testing and robust borrowing relationships have helped improve the risk profile coming into this period of volatility. The Federal Home Loan Banks, the Federal Reserve's Discount Window, and the NCUA's Central Liquidity Facility, or CLF for short, will all be crucial in confronting this tightening portion of the market cycle.

Given this pressure and volatility, it is critical that Congress restore one enhancement made to the NCUA's CLF in the CARES Act. That provision would allow corporate credit unions to once again maintain an agent-member relationship with the CLF for a subset of the

corporate's member credit unions. The CLF acts as a liquidity shock absorber for credit unions and its operations pose no cost for the taxpayer. In October 2022, CBO released an official score of language to reinstate this provision with a budgetary score of zero cost.

When the temporary enhancement was in place, corporate credit unions pledged the capital needed to maintain an agent-member relationship with the CLF for their member credit unions with less than $250 million in assets. When this provision and the associated rules expired at the end of 2022, more than 3,600 credit unions lost access to this emergency liquidity resource and the borrowing authority of the CLF dropped by $9.7 billion.

The entire NCUA Board requests that Congress reinstate this CLF enhancement as soon as possible, especially given the increasing liquidity concerns in the current economic environment.

What liquidity issues have you seen in the past six months and where do you see this liquidity issue headed in 2023?

Response:

The rapid rise in interest rates has left multiple markets in a tough spot. Housing and auto loans, which are both key components of the credit union balance sheets, are experiencing devaluations in securities and loan portfolios. These declines are further felt through securities portfolios where unrealized losses represent over 17 percent of industry capital as of the end of the third quarter of 2022. These declines are apparent for credit unions of all sizes, including those with more than $1 billion in assets. While auto loans are relatively short in duration and should adjust to new rates, lenders that hold longer-duration assets, like mortgage loans, are experiencing margin compression and a longer period of deteriorated earnings.

While we cannot accurately predict the direction of future rates, it appears likely that we're in the beginning of a culmination of liquidity, interest rate risk, capital, and credit stresses which would come through a recession that could negatively impact the industry. However, the credit union system, as a whole, is currently well positioned to withstand this cycle. Nevertheless, as noted earlier, it would be helpful for Congress to reinstate the provisions that allow corporate credit unions to maintain an agent-member relationship with the Central Liquidity Facility for a subset of the corporate's members.

What is NCUA currently doing to prepare itself to meet the anticipated liquidity needs of credit unions?

Response:

In recent years, the NCUA has focused on improving contingency funding plans while communicating interest rate risk stress scenarios to allow institutions to understand how

liquidity and interest rate risk factors affect their balance sheets. All federally insured credit unions with more than $250 million in assets must maintain access to at least one federal liquidity backstop, like the NCUA's Central Liquidity Facility, otherwise known as the CLF, and the Federal Reserve Board's Discount Window. Further, the NCUA has finalized rules over the past two years that offer greater flexibility to hedge interest rate risk using derivatives and allow for the issuance of subordinated debt to fund operations and bolster capital position. Also, a better understanding of balance sheet management through the agency's recently implemented risk-based capital rule has sharpened the industry's ability to detect and mitigate stresses earlier and more effectively.

Prospectively, the NCUA has increased the capability of the CLF to better provide contingent liquidity to a greater number of individual consumer credit unions and protect the system. The CLF has enhanced its operations, streamlined membership applications, and improved loan application and collateral management processes and procedures should the need to make advances become necessary.

The NCUA continues to request that Congress amend the Federal Credit Union Act to permanently provide a corporate credit union with greater flexibility in serving as a member-agent to the CLF for the corporate's member credit unions.

What does Congress need to do in statute to meet those liquidity needs?

Response:

Congress should permanently amend the Federal Credit Union Act in three important ways:

- To provide a corporate credit union serving as an agent member greater flexibility with the amount it must pay to subscribe to the capital stock of the CLF on behalf of the consumer credit unions covered in its agent group. This change would allow a corporate credit union to serve as a member agent for a subset of its members instead of all of its members.

- To remove the reference to "primarily serving natural persons" under the Federal Credit Union Act's definition of "liquidity needs." The change would permit access to emergency liquidity for corporate credit unions.

- To remove the reference to the NCUA Board disapproving applications for extensions of credit that are filed with the "intent to expand credit union portfolios." This provision makes any liquidity advance extended by the CLF cause an expansion in the size of a borrowing member's balance sheet. Just as it was essential to the NCUA's efforts navigating the 2008 financial crisis, the agency's efforts to bolster the system's access to contingent liquidity through the CLF is a central part of its liquidity needs response plan.

Cybersecurity:

3. *Cybersecurity isn't a new challenge, but it's certainly a growing problem. There are more robust requirements for financial institutions around data security than many industries, but we've still seen problems in recent years.*

   It's clear that we need to be doing more to address these threats, whether through coordination, actions from you all and other regulators and agencies, the private sector, or additional work from us here in Congress. Much of that intersects with your work.

   How can you as regulators better help the institutions you regulate protect themselves from cybersecurity threats? Especially smaller community financial institutions

   What more should we be doing to address threats to cybersecurity?

Response:

The vast majority of the NCUA's regulated credit unions are small financial institutions. In fact, about six in ten federally insured credit unions have assets less than $100 million. Thus, the NCUA focuses many of its efforts on smaller credit unions when providing cybersecurity guidance, resources on best practices, and training.

In addition, as part of the FY 2023 Consolidated Appropriations Act (P.L. 117-328), Congress more than doubled the amount of funding available for grants made under the NCUA's Community Development Revolving Loan Fund. Every penny of the $3.5 million appropriated will go to grants, with the NCUA absorbing the administrative costs. With these additional resources now allocated, the NCUA will provide more grants and bigger grants to assist low-income designated credit unions in enhancing their cybersecurity operations.

Furthermore, the agency's Automated Cybersecurity Evaluation Toolbox is a no-cost resource for credit unions that provides access to several risk assessments, including a cyber maturity assessment, that credit unions may use to measure their risk exposure.

The NCUA's primary way of identifying cybersecurity threats in credit unions is through the examination program. The NCUA is now rolling out a new Information Security Examination tool for examiners to use when reviewing a credit union's information security program. This tool will help examiners identify cybersecurity vulnerabilities and provide information to assist credit unions with resolving any issues. The tool is tailored to the size, complexity, and cybersecurity risks of the credit union.

Finally, the lack of third-party vendor authority is a major challenge for ensuring the NCUA's regulated institutions are protected from cybersecurity risks. Credit unions are increasingly turning to third-party providers to perform essential functions, such as information technology infrastructure development and maintenance. Alarmingly, the NCUA has heard anecdotally that some of these service providers are operating overseas, which could further increase cybersecurity risks. Without third party vendor authority, vital credit

union functions are operating within a growing regulatory blind spot, thus putting our nation's national economic security at risk. The Government Accountability Office, the Financial Stability Oversight Council, and the NCUA's Inspector General have all called upon Congress to reinstate the agency's vendor authority.

S.2155:

4. *I think that the pandemic really showed that our bipartisan Economic Growth, Regulatory Relief, and Consumer Protection Act struck the right balance.*

   During the pandemic we saw financial institutions able to step up and serve their communities, with the balance sheets and protections to withstand the economic crisis that came with it.

   In Montana, our community banks and credit unions stood up to make programs like PPP work for small businesses on their Main Streets and keep folks employed.

   Do you think the banking and credit union sectors you oversee are safe and secure right now?

Response:

While the COVID-19 pandemic's economic fallout and a rising interest rate environment have impacted credit union performance over the past year, federally insured credit unions (credit unions) and the National Credit Union Share Insurance Fund (Share Insurance Fund) have remained on a solid footing. Given the pressure and volatility of the increasing interest rates, it is critical that Congress restore the enhancements made to the NCUA's CLF in the CARES Act, most importantly the provision that allows credit unions to put up their own funds through their corporate credit union into the CLF to act as a backstop to any future potential losses. The NCUA refers to this provision as agent membership. These CLF funds act as a shock absorber for credit unions in crisis at no cost to the taxpayer. Due to the December 31, 2021, expiration of this provision, 3648 smaller credit unions lost agent-member access to this emergency liquidity backstop. And, the borrowing authority of the CLF dropped by $9.7 billion. The entire NCUA Board requests that Congress reinstate these CLF enhancements as soon as possible.

5. *Where are there areas that give you concern?*

Response:

There are four risks on the horizon. These include interest rate risk for the institution itself, liquidity risk, cybersecurity risk, and the credit risk that happens particularly as unemployment rises. There is a lagging correlation between unemployment rates and defaults and charge-offs. That lag usually takes one to two years to appear. As a result, the NCUA is

closely monitoring these risk areas and taking appropriate steps to prepare the system for handling these risks.

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Senator Catherine Cortez Masto:

Defrauding of Senior Citizens

1. *What is the most significant barrier NCUA faces in stemming the increase in fraud targeted at seniors as well as people with disabilities?*

Response:

There has been an increase in scams targeted at older Americans and individuals with disabilities. One barrier to combatting this crime is the lack of consumer education on the subject. The NCUA has information and tools available on MyCreditUnion.gov, the NCUA's consumer website, to assist in the detection, prevention, and reporting of these scams.

2. *How is the NCUA working with credit unions to address the increase in 'tech support' scams targeted at seniors?*

Response:

The NCUA continues to work with credit unions to address the increase in tech support scams targeted at seniors. For instance, in May 2022, the NCUA partnered with the Consumer Financial Protection Bureau's Office for Older Americans to host a webinar titled *How Credit Unions Can Protect Older Americans Against Exploitation*. This hour-long webinar is available on the NCUA's YouTube channel and provides credit union participants with an overview of elder financial exploitation; common scams targeted at seniors, including tech support scams; prevention resources; and tools to report abuse. The NCUA also developed a printable one-page document that credit unions may use to educate their staff on filing suspicious activity reports when elder financial abuse is suspected. Additionally, the agency created a video as part of the NCUA's consumer tips video series that aims to help seniors protect their money by avoiding various scams, including tech support scams, and has made the video available to credit unions to share with members.

3. *Could the NCUA work with members and other regulators to develop a consumer toolkit, hotline or web portal that can be utilized in the event of a scam?*

Response:

The NCUA understands the importance of leveraging partnerships to increase access to consumer education resources and will continue to partner with other federal agencies to protect consumers from fraud and scams. The NCUA has a webpage devoted to elder financial exploitation prevention on MyCreditUnion.gov. The webpage provides, among other resources, links to the FDIC's Money Smart for Older Americans, the CFPB's age-friendly promotional toolkit, the National Elder Fraud Hotline, and the National Center on

Elder Abuse. Also available on MyCreditUnion.gov within the NCUA's Fraud Prevention Center, is a link for consumers to report scams to the Federal Trade Commission. We will continue to work within the Treasury Department's interagency Financial Literacy and Education Commission and on a one-on-one basis with other regulators and interested parties to enhance our consumer financial education tools and resources.

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Senator Raphael Warnock:

1. *The recent news about FTX underscores the necessity of robust regulation in our financial markets, especially for novel financial instruments like digital assets and cryptocurrencies that have largely operated freely and with impunity. I understand that this industry touches all four of your agencies differently, and jurisdictional lines are still being drawn. Ultimately it is up to Congress to create a stable regulatory environment for the digital asset industry and to define those lines. However, in the meantime, what are your agencies doing to safeguard everyday Americans and the financial system against a crypto-connected crisis, as we saw with FTX?*

Response:

By and large, the credit union industry has remained insulated from the recent volatility and financial losses being observed in digital assets, like cryptocurrencies and stablecoins, and with digital asset intermediaries. The existence of robust regulation and supervision of insured depositories is a key reason for this stability.

To make the distinction between the traditional financial and digital asset industries clear, the NCUA has been proactive in messaging to credit unions that activities related to digital assets and other uses of distributed ledger technology must be done in compliance with all applicable laws and in a safe and sound manner. Specifically, in December 2021, the NCUA issued Letter to Credit Unions 21-CU-16. The letter clarifies the NCUA's expectations when a federally insured credit union facilitates relationships for its members with third parties that provide uninsured digital asset services to the credit union's members. This letter also identifies risks and risk-mitigation strategies for entering into these third-party relationships including, but not limited to, required disclosures about the non-insured nature of any member digital asset activities conducted with third parties.

Credit unions have limited involvement in digital asset activities, but the NCUA has identified a few instances where federally insured credit unions have considered lending collateralized by crypto assets. In these cases, because of the NCUA's ongoing supervision and examination efforts, activities are identified and evaluated promptly to ensure they are conducted in a manner that protects the credit union, its members, and the Share Insurance Fund.

The NCUA also acknowledges there may be future value to credit unions and members utilizing digital ledger technologies, potentially once a clearer legislative and regulatory framework emerges. To that end, the NCUA issued a second letter, Letter to Credit Unions 22-CU-07, which speaks to risks and expected risk-mitigation strategies that should be taken with respect to the deployment of emerging distributed ledger technologies.

The NCUA has also provided review and technical comments for the drafting of digital asset-related legislation in both houses of Congress, as well as complied with the requirements of White House Executive Order 14067 – *Ensuring Responsible Development of Digital Assets*.

2. *What have you been doing to educate firms and consumers under your jurisdiction about the risks associated with these entities, especially those operating offshore?*

Response:

In July 2022, the NCUA introduced resources to help consumers better understand the risks associated with cryptocurrency and other digital assets. These resources include a cryptocurrency landing page on MyCreditUnion.gov with a video that is also available on the NCUA's YouTube channel and an infographic that explains cryptocurrency risks, common scams, and consumer reporting. Each of these resources advises consumers that no central authority upholds the value of digital assets and expressly states that digital assets are not federally insured. The resources also note that cryptocurrency is a high-risk investment and that investors should only buy what they can afford to lose.

Additionally, as a member of the Financial Literacy and Education Commission, the NCUA works with the commission's other member agencies to create resources that educate and empower consumers and investors to make informed decisions about crypto assets.

3. *Banking deserts drive everyday Americans to use predatory lending services and other firms that take advantage of the lack of options available in communities. What steps are you taking to ensure that folks that live in banking deserts have access to basic banking services?*

Response:

The statutory mission of the credit union system, as outlined in the Federal Credit Union Act, is to meet the credit and savings needs of consumers, especially those of modest means. In pursuit of this mission, new federal credit unions with a community charter and federal credit unions requesting to expand their community charter are required to include as part of their business plan a detailed marketing plan addressing the unique needs of the various demographic groups in the proposed community and how the credit union will market to each group, particularly underserved groups.

Additionally, under the Federal Credit Union Act, credit unions with a multiple common-bond charter may add underserved areas to their field of membership. Underserved areas must qualify as an "investment area" based on the Community Development Financial Institution Fund's economic distress criteria, be a well-defined local community or rural district, and be underserved by other depository institutions.

To allow all types of federal credit unions to add underserved areas, the NCUA strongly supported H.R. 7003, the Expanding Access for Underserved Communities Act, in the 117th Congress. This bill passed the House Financial Services Committee and was added and approved by the House as an amendment to the FY 2023 National Defense Authorization

Act, but it did not become law. The NCUA will support similar legislation in the 118th Congress, if introduced.

In addition, credit unions that hold the NCUA's low-income designation are eligible for technical assistance grants through the NCUA's Community Development Revolving Loan Fund, a congressionally appropriated program. One of the grant initiatives available under this program in recent years provides funds to low-income credit unions seeking to expand their outreach to underserved communities through partnerships, new products and services, and financial literacy programs. Congress recently more than doubled the funding available for these grants, and the NCUA will use the $3.5 million provided to make more grants and bigger grants to expand access to financial products and services in underserved areas.

4. *What are your agencies doing to promote responsible small-dollar lending by the financial institutions you regulate? Please describe how your agencies are measuring the effectiveness of your efforts to date and share supporting data if available.*

Response:

The NCUA supports responsible alternatives to predatory payday loans. To meet this need, the NCUA allows federal credit unions to offer small-dollar, short-term loans under our Payday Alternative Loans (PALs) regulation. The initial PALs rule provides federal credit union members with access to a safe, fair, and affordable alternative to high-cost payday loans. These loans are currently capped at a rate of 28 percent and an application fee of no more than $20. These loans may also amortize over a longer period than high-cost payday loans.

In 2021, federal credit unions granted over 182,000 PALs. In 2022, federal credit unions have granted over 218,000 PALs on an annualized basis, as of the end of the third quarter of 2022. Currently, 569 out of 3,015 total federal credit unions offer PALs. Many federal credit unions also offer small-dollar, short-term loans outside of the PALs program. The rate on these loans cannot exceed 18 percent.

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Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Senator Jerry Moran:

1. *On September 20, 2 Minnesota-based credit unions and 1 Wisconsin-based credit union with combined assets of more than $13 billion sued the Minnesota Department of Commerce over its decision to bar credit unions from acquiring Minnesota-chartered banks. While there have been nearly 60 credit union acquisitions of banks since 2015, Colorado, Iowa, Mississippi, Nebraska, and Minnesota have blocked these transactions via regulatory action or legislation. As ultra-large credit unions grow their membership and expand their commercial lines, are you concerned about growing complexity within the credit union system and potential risk to the Share Insurance Fund?*

Response:

Actually, my real concern relates to consumer financial protection. That's because we have in recent years strengthened our regulatory requirements for larger credit unions in the areas of risk-based capital, stress testing, and capital planning.

For more than three decades, the NCUA has focused its examination program primarily on safety and soundness. This policy worked well when the NCUA oversaw a large number of small credit unions serving a limited field of membership with only a few basic financial products and services, but today's credit unions are, as you note, larger and more complex. At the end of the third quarter of 2022, we had 414 credit unions holding $1 billion or more in assets and serving 94.8 million members.

The NCUA's current compliance examinations covering consumer financial protection laws in credit unions with total assets of $10 billion or less differs from other financial institutions regulators. Federal banking agencies complete regularly scheduled, risk-focused consumer compliance reviews and assign a separate consumer compliance rating outside of the CAMELS process used to assess the safety and soundness of institutions under their jurisdictions. In contrast, the NCUA folds consumer compliance performance into the management component of the CAMELS rating and the management component incorporates the evaluation of more issues than just consumer financial protection. The NCUA's approach to consumer financial protection reviews also runs counter to the congressionally mandated mission of the Federal Financial Institutions Examination Council, which works to develop uniform standards and processes across all financial institution regulators.

Consumers deserve the same level of consumer financial protection and supervision, regardless of the type of financial institution they use. That's why the NCUA should evolve its consumer compliance examination program to conduct separate reviews outside of the CAMELS process for credit unions with more than $1 billion in assets. These changes will better protect consumers. They will also better prepare credit unions for supervision by the Consumer Financial Protection Bureau once a credit union crosses over the $10 billion in assets threshold and into CFPB's supervision.

Ultimately, the NCUA recognizes that a strengthened consumer compliance program is in the best interest of the system and its member-owners and remains committed to enhancing our consumer financial protection program, which buttresses and complements our safety-and-soundness efforts.

2. *Earlier this month, Wings Financial Credit Union, Minnesota's largest credit union with over $8 billion in assets, announced it will acquire Wisconsin-based Settlers Bank, which will make it the largest credit union in Wisconsin (note Wisconsin already has 14 ultra-large credit unions with over $1 billion in assets). The most recent credit union acquisition of a bank cost the state over $1 million in annual tax revenue and this will be Wisconsin's seventh such transaction.*

    a. *Has the NCUA determined how these transactions impact local and state government tax revenue?*

Response:

The NCUA, as a federal government agency, does not have access to data on state and local tax revenue. So, we have not studied the issue. As a general matter, state-chartered credit unions in some states may be subject to state income tax, property tax, and sales taxes. Federal credit unions also are subject to taxes on real and personal property.

In granting or withholding approval of a proposed transaction, the Federal Credit Union Act requires the NCUA to consider six factors. They are:

(1) The history, financial condition, and management policies of the credit union;
(2) The adequacy of the credit union's reserves;
(3) The economic advisability of the transaction;
(4) The general character and fitness of the credit union's management;
(5) The convenience and needs of the members to be served by the credit union; and
(6) Whether the credit union is a cooperative association organized for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes.

These factors are the only basis on which the NCUA may assess proposed transactions, which are negotiated by bank officials acting in the best interests of their shareholders.

Finally, as a prudential regulator, the NCUA's primary concern is the safety and soundness of federally insured credit unions. The tax code currently treats credit unions as not-for-profits, and the only way many credit unions can generate capital is through retained earnings. Taxing credit union income would have a negative impact on the ability of credit unions to generate and maintain healthy capital levels, as well as limit their ability to invest in new branches, new technology, products, and services. From a safety-and-soundness perspective, taxing credit unions is therefore something that would cause serious concern for NCUA.

b. *Likewise, has the NCUA examined whether the surviving entity should continue to pay taxes or have CRA reporting requirements?*

Response:

The applicability of CRA to credit unions is a matter for Congress to decide. Several states have adopted CRA-like requirements for their state-chartered credit unions, but for federal credit unions, this would be an issue for congressional consideration. If Congress chose to apply CRA to credit unions, the NCUA would need some flexibility to develop regulations related to the credit union's charter type and size.

Similarly, statutory provisions on taxation are determined by Congress and state legislatures and are not within the NCUA's power to change. The Federal Credit Union Act exempts federal credit unions from taxes other than taxes on real and personal property, and many state laws exempt state-chartered credit unions from certain state taxes.

3. *On November 2, NCUA published a Research Note on Credit Unions' Mortgage Lending to Minority Borrowers, which found that "many minority credit union borrowers faced higher loan denial rates, and Black and Hispanic credit union borrowers paid higher interest rates than White borrowers." While it acknowledges that "credit unions necessarily serve specific fields of membership" and "the share of minority borrowers in these FOMs may be systemically different than for the overall market," how will that change with the growth of community chartered and open charter credit unions?*

Response:

The NCUA has not and does not offer "open charters." Further, federal credit unions are generally only able to grant loans and provide services to persons within the field of membership who have become members of the credit union. There are three types of fields of membership offered:

1. Single common-bond credit union – One group having a common bond of occupation or association.
2. Multiple common-bond credit union – Combination of distinct, definable single occupational common bonds, associational common bonds, or both.
3. Community credit union – Persons who live in, worship in, attend school in, or work in a well-defined community or rural district.

Every credit union is required to have objective lending policies and procedures and is prohibited from discriminating on any restricted basis under various federal laws, such as the Fair Housing Act and the Equal Credit Opportunity Act. The type of charter should not affect

a credit union's lending practices, although each type of charter will affect which consumers are eligible to become members.

Since I became an NCUA Board Member, the agency has increased the size of its fair lending staff. We have also more than doubled the number of fair lending reviews and exams that we conduct each year. I remain committed to continuing to ensure that credit union lending is solely based on a borrower's creditworthiness and not their race, color, age, marital status, or sexual orientation, among other factors.

4. *At last month's NCUA Board Briefing on the 2023 – 2024 Budget, there was some discussion around "complex" credit unions, which according to NCUA regulations are those with more than $500 million in assets. Certainly, the credit union industry has evolved throughout the last several years as the overall number of credit unions has dwindled and the number of those with over $500 million has grown. Credit union acquisitions of banks and other credit unions, charter conversions, and less stringent field of membership requirements have undoubtedly influenced those trends. Have these ultra-large credit unions evolved to the point that the regulations governing them should be reexamined and perhaps updated by Congress?*

Response:

The laws that govern credit unions are for Congress to debate and update, as necessary.

Additionally, at the start of 2022, the NCUA implemented its long-delayed risk-based capital regime for federally insured credit unions with more than $500 million in assets. And, for credit unions with more than $10 billion in assets, we have put in place stress testing and capital planning requirements. So, we are already updating our regulations to respond to this change in the size of credit unions and to protect the Share Insurance Fund from losses.

Nevertheless, there are two primary areas lacking in the oversight of credit unions with assets above $500 million. The first, which would require congressional action, is the NCUA's lack of third-party vendor authority. The lack of vendor authority is a growing regulatory blind spot for the agency. The Congressional Budget Office, the Financial Stability Oversight Council, and the NCUA's Inspector General have recommended providing the agency with vendor authority. Federal banking agencies all have the power to examine and supervise vendors, yet the NCUA's temporary vendor authority expired in 2002. It's time put credit union vendors on a level playing field.

The second is a more thorough examination of credit union compliance with consumer financial protection laws and regulations. I am committed to enhancing the NCUA's consumer financial protection examination program, which buttresses and complements our safety-and-soundness efforts. And, as I noted earlier, we should evolve our consumer compliance examination efforts to complete regularly scheduled, risk-focused consumer compliance reviews for larger sized credit unions and then assign a separate consumer

compliance rating outside of the CAMELS process, just as federal banking regulators already do.

5. *CRA stakeholders—including some community advocates—have raised concerns that the interagency CRA proposal is overly partisan, which could result in a rulemaking that will not stand the test of time. Do you believe the durability of a new regulatory framework is important? What can the agencies do to ensure that a modernized regulation will not fall victim to shifting political winds, a result that would not benefit communities, banks, or regulators?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

6. *Many comment letters responding to the interagency CRA proposal expressed concern about the complexity of the proposed Retail Lending Test and its associated performance metrics. Is this a concern that you share? Do you believe that the test and its performance metrics would understandable and manageable for community banks—including community banks with assets of only $2 billion that will be considered "large banks" under the proposal?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

7. *According to the preamble to the proposal, 34% of "large" banks (defined as having assets of $2B or more) would fail the Retail Lending Test in their new Retail Lending Assessment Areas. Numerous times, the proposal states that this is "appropriate" but does not explain the agencies' rationale for proposing performance benchmarks that would represent such a significant shift in CRA ratings. Please explain why the agencies believe it is "appropriate" to set the Retail Lending performance measures at a level where 1/3 of banks would receive an Unsatisfactory rating in their Retail Lending Assessment Areas. Follow-up: CRA performance benchmarks should be rigorous, yet achievable, and the expectation should be that all banks can meet or exceed the established standard—as is the case with all other consumer protection and safety and soundness regulations. Do you agree that artificially high benchmarks could incentivize banks to engage in undue risk taking in order to comply with the regulation's performance standards?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

8. *To address the development and proliferation of digital banking, the proposed CRA rule would create new Retail Lending Assessment Areas (RLAA) where a bank makes more than 100 mortgages or 250 small business loans.*

   A – Have the agencies analyzed where these new assessment areas would be created? If so, can you share that information with us? [Note: ABA's preliminary analysis using existing HMDA and CRA data finds that most RLAAs would be located in areas currently well-served by banks, which could add to the problem of hot-spots and not encourage CRA activities in underserved areas.]

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

9. *Cost/benefit analysis: The actual benefit to communities and consumers targeted by CRA should be measured against the substantial increase in regulatory burden. How have the agencies determined that the proposal strikes this balance? Are there less burdensome alternatives that could accomplish this objective?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

10. *Implementation period: The proposed one-year implementation period following publication of a final rule is too short given the complexity of the proposal and we believe a longer period is necessary. One year is not an adequate amount of time for banks to turn operations over to a new regime of requirements and collect and report the data required for benchmarking and comparisons. Given these significant constraints, will the agencies consider a longer implementation period?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

11. *Performance standards: At a June 6 forum sponsored by the Urban Institute, FDIC Chair Martin Gruenberg said the following: "Raise the bar for performance, meaning, what a bank did before to earn an Outstanding or High Satisfactory will not be sufficient. They will have to engage in more lending activity to earn the recognition. The goal is more lending to more low- to moderate-income communities." Banks already make great efforts to serve their communities through CRA, but Mr. Gruenberg's statement implies that banks are not doing enough. Why do the agencies believe the bar needs to be raised for CRA performance? A 125% threshold for Outstanding performance will practically eliminate the opportunity for banks with significant market share in any market to achieve an Outstanding rating in that market. How and why were the thresholds established?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

12. *Thresholds: While we understand the agencies have given some background to the reasoning for the specific thresholds (p 33919), we believe the proposed mortgage and small business loan thresholds for delineating retail lending-based assessment areas need to be increased or include other modifications. As proposed, many banks would have increased assessment areas far beyond current requirements (e.g., one institution in our membership would have a 700% increase in assessment areas). As a possible unintended consequence, these low thresholds may lead to reduced lending, leaving borrowers with few options.*

    a. *Have the agencies considered the possible consequences of banks pulling out of certain possible assessment areas due to the impracticality of adding additional countywide MSAs due to low volume thresholds?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

b. Have the agencies considered alternatives to the proposal including on national out of footprint area?

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

13. Retail lending test: Several areas of the proposal do not fully account for the transition of the industry toward digital delivery channels, especially for banks that primarily or exclusively serve customers through digital channels. For example, it is unclear how a digital bank could pass the Retail Services and Products Test given the test's focus on branch distribution. Additionally, the Retail Lending Test is tied to specific geographies, but in practice, digital lending is not related to any specific geography, meaning many digital banks will be scrutinized under the RLT simply because they happened to make 100 mortgage or 250 small business loans in a given geography. Will the agencies consider further tailoring the rule to account for digital banks?

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

14. *Strategic plans: The strategic plan option in the proposal seems less flexible than under the current CRA framework, and the agencies seem to be backing away from an option they have often asked banks to consider under the current framework. The proposal contains very little information about when a strategic plan might warrant flexibility with respect to the otherwise applicable standards and does not detail the extent of the available flexibility. Since the proposed strategic plan option would not be much different from evaluation under the relevant performance test, will the agencies provide some transparency on how the strategic plan option will maintain flexibility for banks that do not fit into the conventional retail framework, such as digital banks and banks focused on consumer lending?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

15. *Indirect lending: In an indirect lending scenario, banks have little contact and little discretion targeting LMI borrowers. Have the agencies considered excluding indirect auto loans, or other types of indirect financing including equipment, RV, marine, etc., from the auto lending evaluation?*

Response:

The Community Reinvestment Act does not apply to federal credit unions. The NCUA has no authority in the oversight or enforcement of CRA, and the agency played no role in developing the federal banking agency CRA proposal. I defer to the capable leadership of the federal banking agencies to discuss their views and work on this important matter.

16. *More than half American consumers are finding it difficult to meet emergency financial needs according to a recent GAO study. Over the last decade, there have been 19 regulatory actions pertaining to small dollar lending, many of which have all but killed the small dollar market for depository institutions and pushed consumers to the less regulated and less supervised alternative lending markets like payday lenders. As noted by the GAO, many depository institutions are hesitant to dedicate the resources needed to adequately develop small-dollar products that will help consumers meet their monetary shortcomings.*

    a. *Do you believe there is a need for small dollar loan product offered by highly regulated depository institutions?*

Response:

Yes. To meet this need, the NCUA allows federal credit unions to offer small-dollar, short-term loans under our Payday Alternative Loans (PALs) regulation. The initial PALs rule provides federal credit union members with access to a safe, fair, and affordable alternative to high-cost payday loans. These loans are currently capped at a rate of 28 percent and an application fee of no more than $20. These loans may also amortize over a longer period than high-cost payday loans.

In 2021, federal credit unions granted over 182,000 PALs. In 2022, federal credit unions have granted over 218,000 PALs on an annualized basis, as of the end of the third quarter of 2022. Currently, 569 out of 3,015 total federal credit unions offer PALs.

Many federal credit unions also offer small-dollar, short-term loans outside of the PALs program. The rate on these loans cannot exceed 18 percent.

    b. *Do you believe it is important for the banking agencies to coordinate small dollar lending policies? What are you doing to facilitate that?*

Response:

Yes. The NCUA recognizes the important role that small-dollar, short-term loans can play in helping borrowers meet credit needs due to cash-flow imbalances, unexpected expenses, or temporary income shortfalls. And, the NCUA regularly coordinates with other agencies on consumer financial protection issues, including small-dollar lending.

For example, the NCUA worked with the Defense Department to create a safe harbor for federal credit unions offering loans under the agency's initial PALs rule within the department's Military Lending Act requirements. Additionally, the Consumer Financial Protection Bureau previously granted a safe harbor within the bureau's payday lending regulation for small-dollar, short-term loans made under the NCUA's initial PALs rule. And, in May 2020, the NCUA joined with the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Office of the Comptroller of the Currency to issue interagency guidance encouraging supervised banks, savings associations, and credit unions to offer responsible small-dollar loans to customers for both consumer and small business purposes.

Imposing Liability on Banks for Authorized P2P Payments to Scammers

17. *There have been rumors that the CFPB is planning to shift liability for P2P payments that consumers make to a scammer. Obviously, scammers will profit from such a policy because, armed with an official government document, they will be able to induce people to pay them by telling them there is no risk in sending the money –even if the circumstances are suspicious. However, banks, unlike the consumer, would have no insight into the transaction to be able to stop it. Are you concerned about: The impact on bank safety and soundness given banks' inability to identify or stop the fraud and the size of potential fraud losses banks would incur? The impact on competition if small banks in particular cannot offer the product because the risk of loss is too much to bear? The harm to consumers if banks begin charging for these very popular services, limiting access to the product, or adjusting the model to reduce the potential for fraud loss (i.e., imposing delays in consumer access to the money or limiting transaction amounts or the number of transactions), which will reduce the value or appeal of P2P services?*

Response:

A shift in liability to financial institutions could cause some credit unions to limit or eliminate participation in peer-to-peer products due to the risk of loss, fees to offset potential losses, reputation risk, or the impact on safety and soundness. The NCUA will continue to monitor this important issue.

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1. In your testimony, you highlighted a number of risks on the horizon for the banking system. In order to be prepared for all these risks, banks need strong capital so that they can continue to lend and serve their customers in a downturn. While the largest institutions in the industry claim that stronger capital requirements reduce lending, we saw in 2020 that even while banks were receiving government support, they used their supposedly scarce capital to pay dividends and buyback their stock.

   Why do strong capital requirements protect the banking and credit union system and how do they ultimately better protect working Americans? What are your agencies doing to achieve this goal?

Response

Strong regulatory capital requirements are a critical element of the bank regulatory framework. Banks with strong capital positions are better able to absorb losses, allowing them to serve as a source of strength for the U.S. economy by continuing to lend to consumers and businesses during times of economic stress. The FDIC, along with the Federal Reserve Board and the Office of the Comptroller of the Currency, is committed to further bolstering the robustness of the regulatory capital framework by implementing enhanced regulatory capital requirements that align with the final set of Basel III standards issued by the Basel Committee on Banking Supervision in December 2017.[1] The implementation of these standards for large banking organizations would further strengthen the resilience of the domestic banking system. The agencies plan to issue a joint proposed rule seeking public comments on these new capital standards in the near future. The capital requirements for community banking organizations will not be impacted by this proposal.

2. Most agree that a well-designed regulatory capital framework includes risk-based requirements and a leverage ratio "back-up." The supplementary leverage ratio (SLR) is that back-up. It protects against emerging risks not yet included in the risk-based framework, and against the potential for unexpected losses to be underestimated.
   a. Do you agree, that the risk insensitive SLR is necessary, and most effective when it includes all of the bank's assets?

[1] See, https://www.bis.org/bcbs/publ/d424.htm.

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Response

The supplementary leverage ratio is, in my view, a key post-crisis reform and an important element of the agencies' regulatory capital framework. The supplemental leverage ratio is an unweighted measure of equity as a percentage of a bank's exposures that is designed to constrain a bank's overreliance on debt. The risk-based capital requirements, while risk-sensitive, use risk measures that have at times dramatically underestimated a bank's actual risk and can be managed in a manner that allows the bank to obfuscate its true risk profile. The leverage framework, while relatively simple, does not differentiate assets by risk and ensures that banks hold a minimal level of regulatory capital that is proportional to their exposures. The two frameworks are complementary and work together to provide a stronger capital foundation than either would in isolation.

b. Some fear that including Treasury securities, held on bank balance sheets, in the SLR may lead to problems in Treasury markets. Given the Federal Reserve's standing repurchase agreement facilities and the Inter-Agency Working Group on Treasury Market Surveillance's progress at making the U.S. Treasury market more resilient, is this still a concern? Please explain.

Response

In her October 22, 2022 remarks at the Securities Industry and Financial Markets Association's Annual Meeting,[2] Treasury Secretary Yellen stated that the Treasury market is reflecting greater uncertainty about the economic outlook, but that trading volumes are robust and investors are able to execute transactions. Secretary Yellen also noted the importance of enhancing Treasury market resilience and that Treasury is working with financial regulators to advance reforms that improve the Treasury market's ability to absorb shocks and disruptions.

I share Secretary Yellen's sentiment that a robust, resilient Treasury market is important for the U.S. economy. However, to date, little empirical evidence has been provided that shows that the supplemental leverage ratio is detrimental to the overall resilience of the Treasury market.

3. Industry consolidation and concentration can hurt local communities and their economies. President Biden has called for a plan to strengthen bank merger guidelines in his Executive Order on Competition. The Fed and the OCC recently approved a megamerger resulting in

[2] See, https://home.treasury.gov/news/press-releases/jy1045.

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the 7th largest bank in the United States and are currently reviewing another one, but at the same time, the Fed, FDIC, and OCC have raised concerns about domestic systemically important banks. What is your plan to strengthen the bank merger guidelines and look at these mega mergers more closely to ensure they work for Main Street?

Response

A review of the bank merger process is a priority for the FDIC, recognizing that there has not been a comprehensive review of the area in some 25 years.[3] Section 18(c) of the Federal Deposit Insurance Act (FDI Act),[4] which codifies the Bank Merger Act (BMA), prohibits an insured depository institution (IDI) from engaging in a merger transaction without regulatory approval.[5] The FDIC is one of three federal banking agencies with responsibility for evaluating transactions subject to the BMA. The FDIC has jurisdiction to act on merger applications that involve an IDI and any non-insured entity, notwithstanding the IDI's charter.[6] The FDIC also has jurisdiction to act on merger applications that solely involve IDIs in which the acquiring, assuming, or resulting institution is an FDIC-supervised institution.[7]

In order to implement its responsibilities under the BMA, the FDIC has codified regulations;[8] issued a Statement of Policy;[9] and adopted and published the Applications Procedures Manual (APM),[10] which provides application-processing instructions for FDIC staff, including a section on processing merger applications. Additionally, together with the other Federal banking agencies, the FDIC has issued an interagency application form.[11]

On March 31, 2022, the FDIC published a Request for Information and Comment on Rules, Regulations, Guidance, and Statements of Policy Regarding Bank Merger Transactions (RFI).[12] The RFI requested comment on the elements the FDIC must consider in reviewing bank merger applications: competition, prudential risk, the convenience and needs of the communities affected, and financial stability. The FDIC received 31 thoughtful comment letters, and through our review have identified some common themes, including requests to enhance the competitive

[3] See https://www.fdic.gov/news/press-releases/2022/pr22015.html.
[4] 12 U.S.C. § 1828(c).
[5] 12 U.S.C. §1828(c)(2).
[6] 12 U.S.C. § 1828(c)(1)(A).
[7] 12 U.S.C. § 1828(c)(2)(C).
[8] 12 CFR § 303.60-303.65, https://www.ecfr.gov/current/title-12/chapter-III/subchapter-A/part-303#subpart-D.
[9] Statement of Policy on Bank Merger Transactions, https://www.govinfo.gov/content/pkg/FR-2008-02-15/pdf/E8-2885.pdf.
[10] Applications Procedures Manual § 4, https://www.fdic.gov/regulations/applications/resources/apps-proc-manual/section-04-mergers.pdf.
[11] Interagency Bank Merger Act Application, https://www.fdic.gov/formsdocuments/f6220-01.pdf.
[12] 87 Fed. Reg. 18368 (March 31, 2022).

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effects analysis, to strengthen the assessment of the convenience and needs of the community(ies) served, and to establish criteria to assess the risk to the stability of the U.S. banking or financial system, which is a relatively new statutory factor in the bank merger process that was added through the Dodd-Frank Act.[13] We will consider these comments as we make changes to the FDIC's framework, as appropriate.

The FDIC has also participated in discussions with the Federal Reserve Board, OCC, and the Department of Justice, as appropriate, regarding an interagency review of the existing laws, regulations, guidance and processes used by the federal banking agencies under the BMA. These discussions, which are ongoing, are consistent with the Executive Order on competition.

[13] See, § 604(f) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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Crypto

1. During the hearing on November 15, 2022, Federal Reserve Board (FRB) Vice Chair for Supervision Barr stated that it would be "useful for [the banking agencies] to provide guidance to the banking sector about how to safely custody crypto assets." In July 2020, however, the Office of the Comptroller of the Currency (OCC) issued guidance stating that national banks may provide custody services for crypto assets.[14]

    a. Do you agree that it would be useful for the OCC to provide further guidance to the banks it regulates about how to safely custody crypto assets?

Response

On April 7, 2022, the FDIC issued Financial Institution Letter FIL-16-2022, Notification of Engaging in Crypto-Related Activities,[15] to address FDIC-supervised institutions' engagement in crypto asset-related activities. The FDIC requested that all FDIC-supervised institutions that are considering engaging in, or are already engaged in, crypto asset-related activities to notify the FDIC and to provide all necessary information that would allow the FDIC to engage with the institution to assess the safety and soundness, consumer protection, anti-money laundering/countering the financing of terrorism (AML/CFT), and financial stability risks and provide supervisory feedback. The FDIC established this case-by-case approach to gain a better understanding of the risks of the specific crypto-asset related activities by FDIC-supervised banks. Most recently, on January 3, 2023, the FDIC, along with the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency, released a Joint Statement on Crypto-Asset Risks to Banking Organizations.[16] This statement enumerated several risks posed by crypto-assets that banking organizations should be aware of, including significant volatility in crypto-asset markets; risk management and governance practices in the crypto-asset sector exhibiting a lack of maturity and robustness; and inaccurate or misleading representations or disclosures by crypto-asset companies, among others. The FDIC will continue to provide oversight and monitor the potential risks posed by crypto-asset related activities to supervised institutions.

[14] https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf.
[15] See: https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html.
[16] See: https://www.fdic.gov/news/press-releases/2023/pr23002.html.

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b. Do you agree with the OCC's analysis? If not, please explain whether you believe national banks may provide custody services for crypto assets and whether you believe that providing custody services for crypto assets differs from any other assets for which banks provide safekeeping and custody services.

Response

The OCC's analysis in Interpretive Letter 1170[17] speaks to the legal permissibility of crypto custody activities for national banks. The FDIC does not deem activities to be permissible or impermissible; that authority lies with the Office of the Comptroller of the Currency for national institutions and the states for state chartered institutions.

The OCC superseded Interpretive Letter 1170 through its issuance of Interpretive Letter 1179, which clarifies that the activities addressed in Interpretive Letters 1170, 1172, and 1174 are legally permissible for a bank to engage in, provided the bank can demonstrate, to the satisfaction of its supervisory office, that it has controls in place to conduct the activity in a safe and sound manner.[18] OCC's Interpretive Letter 1179 states that, consistent with longstanding OCC precedent, a proposed activity cannot be part of the "business of banking" if the bank lacks the capacity to conduct the activity in a safe and sound manner. OCC's Interpretive Letter 1179 further states that a bank should notify its supervisory office, in writing, of its intention to engage in any of the activities addressed in the three interpretive letters. OCC further states the bank should not engage in the activities until it receives written notification of the supervisory office's non-objection. In deciding whether to grant supervisory non-objection, the supervisory office will evaluate the adequacy of the bank's risk management systems and controls, and risk measurement systems, to enable the bank to engage in the proposed activities in a safe and sound manner.

This practice is substantively similar to the process the FDIC outlined in FIL-16-2022, Notification of Engaging in Crypto-Related Activities. One purpose of the case-by-case review is to evaluate whether the risks of crypto asset-related activities by banks, including custody services, may differ from the risks of other assets.

2. Earlier this year, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin 121 (SAB 121), which provides that crypto assets held in custody

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[17] See: https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-98.html.
[18] See: https://www.occ.gov/news-issuances/news-releases/2021/nr-occ-2021-121.html.

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should be treated as on-balance sheet assets.[19] It has been reported that the SEC staff "did not consult with the banking regulators" before issuing SAB 121.[20] This staff guidance is posing significant challenges for crypto custody by banks, which are subject to capital and liquidity requirements based on their balance sheet assets.

a. Do you believe that the SEC staff guidance is appropriate? Please explain.

Response

The SEC has primary responsibility for the financial statement reporting requirements of publicly traded organizations in the United States. As SAB 121 applies to all publicly traded organizations, and not solely to regulated banking organizations, the FDIC defers the determination of the appropriateness of this guidance to the SEC.

b. Are you aware of any other assets held in custody that are treated as on-balance sheet assets under U.S. generally accepted accounting principles (GAAP)?

Response

The FDIC is not presently aware of situations that result in assets held in custody being reported as on-balance sheet assets. However, there are situations in which a financial institution's activities associated with custody assets could result in the recognition of an on-balance sheet exposure. For example:

- In accordance with ASC Subtopic 450-20, Contingencies – Loss Contingencies, an estimated loss (or expense) from a loss contingency (for example, pending or threatened litigation) must be accrued by a charge to income if it is probable that a liability has been incurred as of the report date and the amount of the loss can be reasonably estimated.

- In accordance with ASC Topic 460, Guarantees, a liability is recognized by a guarantor at the inception of a guarantee for the obligations the guarantor has

[19] https://www.sec.gov/oca/staff-accounting-bulletin-121.
[20] https://www.reuters.com/technology/us-secs-crypto-guidelines-push-up-costs-lenders-disrupting-projects-2022-09-16/.

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undertaken in issuing that guarantee, including contingent guarantees, indirect guarantees and indemnification agreements.

c. Have the banking agencies ever allowed regulated banks to depart from GAAP for purposes of bank regulations? If so, please describe those circumstances.

Response

The Federal banking agencies have made adjustments in their regulatory capital rules that introduce differences between the treatment of regulatory capital and what is reported as equity under GAAP. For example, the Federal banking agencies allow banking organizations to transition into regulatory capital over a period of time the impact associated with implementation of the current expected credit losses methodology. In addition, the federal banking agencies' regulatory capital regulations include certain adjustments and deductions associated with intangible assets, goodwill, mortgage servicing assets, certain deferred tax assets, and investments in the capital of unconsolidated financial institutions; however, these adjustments are generally more stringent than GAAP. There are circumstances in which the federal banking agencies' regulatory capital standards allow certain elements of the equity account under GAAP to be adjusted or modified for regulatory capital purposes, usually when the GAAP treatment would create outsized regulatory burden or uncertainty for community banks. For example, most community banks do not include elements of accumulated other comprehensive income in regulatory capital, such as net unrealized gains and losses on available for sale debt securities.

3. On November 23, 2021, the Fed, the Federal Deposit Insurance Corporation (FDIC), and the OCC issued a statement describing their crypto-asset policy sprint initiative and next steps.[21] The statement noted that, throughout 2022, the agencies plan to provide "greater clarity on whether certain activities related to crypto-assets conducted by banking organizations are legally permissible," including the issuance and distribution of stablecoins. Although the Fed, FDIC, and OCC have not provided further guidance on bank-issued stablecoins, a recent paper asserts that issuing stablecoins "clearly fall[s] within the existing legal authority of banks to conduct the business of banking."[22]

   In your view, is it legally permissible for OCC-regulated banks to issue stablecoins?

   a. If not, how do you distinguish stablecoin issuance from this activity?

[21] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.
[22] https://www.theclearinghouse.org/payment-systems/Articles/2022/11/11082022_Stablecoin-related_Activities.

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Response

There are numerous types of stablecoins, each with varying and different features and structures. Stablecoins have predominantly been used as a vehicle to buy and sell crypto–assets for investment and trading purposes. Unlike Bitcoin, Ether, and similar crypto–assets, most stablecoins are represented as backed by a pool of assets or utilize other methods to help maintain a stable value. Currently, the most prominent stablecoins are purported to be backed by financial assets such as currencies, U.S. Treasury securities, or commercial paper.

From the FDIC's perspective, before banks engage in crypto–asset related activities, it is important to ensure that: (a) the activity can be engaged in a safe and sound manner; (b) the bank has put in place appropriate measures and controls to identify and manage the novel risks associated with those activities; and (c) the bank can ensure compliance with all relevant laws, including those related to anti–money laundering/countering the financing of terrorism, and consumer protection; as well as ensuring that the specific activity is permissible under applicable law and regulation.

The FDIC does not deem activities to be permissible or impermissible; that authority lies with the Office of the Comptroller of the Currency for national institutions and the states for state chartered institutions. It should be noted, however, that even activities deemed permissible must be conducted in a safe and sound manner (see e.g., sections 8 and 39 of the Federal Deposit Insurance Act),[23] such that they do not present significant risks to the Deposit Insurance Fund and are consistent with the purposes of Federal deposit insurance and other applicable law. Whether it is legally permissible for FDIC-regulated banks to issue stablecoins will depend upon the specific features of the instrument to be issued, and the facts and circumstances underlying the issuance of the instrument.

Without knowing the facts and circumstances for a specific stablecoin issuance, it is not possible to assess the similarities or distinguishing characteristics of such an issuance and deposit taking activities.

Credit Underwriting

4. On November 16, 2022, the U.S. Department of the Treasury released a report entitled *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets*. Among other things, the report recommends that federal banking regulators

[23] See, 12 U.S.C. § 1818 and 12 U.S.C. § 1831p-1.

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"engage with supervised institutions that are seeking to prudently implement new credit underwriting approaches—including those using alternative data analytics to inform credit decisions" in order to increase competition in consumer credit underwriting. Often, insured depository institutions (IDIs), particularly small and mid-sized IDIs, turn to fintech partnerships to develop and implement innovative consumer underwriting approaches.

a. How have you helped small IDIs build responsible partnerships that offer wider access to credit through underwriting innovation?

Response

As a federal banking regulator, the FDIC does not direct IDIs of any size to seek specific third-party relationships. Rather, the FDIC has had longstanding guidance on managing third-party relationships, offering a principles-based framework for identifying, assessing, and mitigating risks.[24] IDIs have the responsibility to conduct their activities in a safe and sound manner, and in compliance with all applicable laws and regulations, including those that protect consumers. The use of third parties does not diminish that responsibility.

The FDIC has offered guidance about lending that could be applicable whether the IDI does the activity itself or as part of a relationship with a third party. For example, in December 2019, the federal banking agencies (FDIC, OCC and Federal Reserve) and the National Credit Union Administration issued a joint statement on the use of alternative data for credit underwriting.[25] In that statement, the agencies stated "that use of alternative data may improve the speed and accuracy of credit decisions and may help firms evaluate the creditworthiness of consumers who currently may not obtain credit in the mainstream credit system. Using alternative data may enable consumers to obtain additional products and/or more favorable pricing/terms based on enhanced assessments of repayment capacity. These innovations reflect the continuing evolution of automated underwriting and credit scoring models, offering the potential to lower the cost of credit and increase access to credit." The statement also recognizes the need for IDIs to assess the risks of using such data, especially in terms of compliance with consumer protection laws.

[24] See, *FIL-44-2008, Third-Party Risk Guidance for Managing Third-Party Risk,* available at https://www.fdic.gov/news/financial-institution-letters/2008/fil08044.html.
[25] See, FIL-82-2019, available at https://www.fdic.gov/news/financial-institution-letters/2019/fil19082.html.

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In 2020, the same four agencies issued interagency guidance on small-dollar lending. In this guidance, the agencies sought to promote responsible small dollar lending, recognizing that there are segments of populations whose credit needs remain unmet.

The FDIC encourages the IDIs it supervises to provide wider access to credit, including through innovations in credit underwriting, so long as all lending activity is conducted in a safe and sound manner and in compliance with all applicable laws and regulations, including those that protect consumers.

b. In light of the Treasury report, what additional steps will you take to expand responsible fintech partnerships that innovating in the underwriting space?

Response

As noted above, the FDIC is a federal bank regulator. As such, it does not direct IDIs to engage in relationships with specific third parties, including fintechs. The FDIC encourages responsible innovation, including the use of alternative data in underwriting, so long as the activity is conducted in a safe and sound manner and in compliance with all applicable laws and regulations. Such activities may be conducted by an IDI itself or an IDI in a relationship with a third party.

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1. In your Section 342 Report to Congress for 2021, the percentage of Hispanic and Black professionals in your overall workforce was not immediately identifiable. The FDIC previously included this data in their 2020 report.

   a. What percent of your overall workforce was Hispanic or Latino at the end of 2021?

Response

On December 31, 2021, 4.5% of the FDIC workforce was Hispanic or Latino.

   b. What percent of your overall workforce was Black at the end of 2021?

Response

On December 31, 2021, 17.2% of the FDIC workforce was Black or African American.

   c. Will you commit to making this data easily identifiable in future reports?

Response

Yes, in future reports the FDIC will provide disaggregated race and ethnicity data for employees who identify as Hispanic/Latino or Black/African American, as well as for other groups in the overall workforce.

Further, the FDIC is committed to fostering a diverse and inclusive workplace. We will continue to monitor racial and ethnic representation in our workforce and strategically develop initiatives to recruit and retain a diverse cadre of talented employees.

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Community Reinvestment Act:

1. During the hearing, we discussed your agencies' proposed changes to the Community Reinvestment Act, and how they would incorporate the unique needs of rural communities and Indian Country into their proposal.

How will you evaluate success of those changes?

One of the greatest challenges I hear about in communities across Montana, and most places across the country, is the availability of housing people can afford – there just isn't enough.

<u>Response</u>

Affordable housing is a significant challenge across the country, and commenters on the NPR have highlighted the unique challenges of affordable housing in rural and native communities. One measure of success for CRA rulemaking would be an indication of more banks engaging in the financing of affordable housing in rural and native communities.

To achieve this objective, the agencies requested feedback on a range of issues centered on affordable housing and serving rural and native communities. Among other things, commenters were asked to provide comment on issues such as the definition of affordable housing; affordability standards for rental units; and the development and maintenance of affordable units for various geographies and housing types. Depending on the language of the final rule, agencies may receive much more data about affordable housing which would allow the FDIC and the other agencies to gain a better understanding of housing-related activities being undertaken by institutions subject to CRA requirements.

The NPR does include some important provisions that could directly address the challenge you identify. For example, the NPR would give banks CRA community development credit for activities in rural areas, such as the development of affordable rental housing, even when those activities take place outside of a bank's "brick and mortar" assessment areas. The proposal would also broaden eligible community development activities to encourage bank engagement in Native Land Areas by including a separate Native Land Areas definition and eligible community development activities in these areas.

Housing:

2. How would these CRA changes effect housing supply?

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Response

As noted above, the agencies requested feedback on a number of issues surrounding affordable housing. The agencies will review and consider all comments as well as available data when crafting a final rule. Upon implementation, agencies may have access to much more data to continue evaluating impacts to housing supply and other housing related issues.

Cybersecurity:

3. Cybersecurity isn't a new challenge, but it's certainly a growing problem. There are more robust requirements for financial institutions around data security than many industries, but we've still seen problems in recent years.

It's clear that we need to be doing more to address these threats, whether through coordination, actions from you all and other regulators and agencies, the private sector, or additional work from us here in Congress. Much of that intersects with your work.

How can you as regulators better help the institutions you regulate protect themselves from cybersecurity threats? Especially smaller community financial institutions

Response

To help institutions protect themselves, we need to continue to collaborate with other financial regulatory agencies, with security and law enforcement agencies, and with private sector entities to monitor and understand new cyber threats ourselves, and ensure banks and their service providers have access to good cyber threat information. The Financial and Banking Information Infrastructure Committee (FBIIC),[44] led by the U.S. Department of the Treasury, is a primary vehicle for this collaboration. Through the FBIIC, we collaborate as well with the Financial Services Sector Coordinating Council (FSSCC).[45] In September, I addressed a joint meeting of the groups and highlighted the effectiveness of the joint work.[46]

As we detect new cyber threats, we will identify the related defensive controls, and adjust guidance and examination procedures when needed. In many cases, controls that are effective in defending against a known cyber threat are also effective in defending against new threats. But,

[44] Information on the FBIIC is available at https://www.fbiic.gov/.
[45] Information on the FSSCC is available at https://fsscc.org/.
[46] *Remarks by FDIC Acting Chairman Gruenberg to the Joint Meeting of the FBIIC and the FSSCC*, September 16, 2022: https://www.fdic.gov/news/speeches/2022/spaug0322.html.

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controls continue to improve and our guidance and examinations need to continue to change, as well. As noted in the comments to the joint FBIIC-FSSCC meeting referenced above, the FDIC is currently focused on the ransomware threat, as an example. In this case we are now piloting new technical examination aids for examiners to use to provide even more meaningful feedback to banks.

When cyber threats and incidents affecting banks are severe, we instruct banks to share incident information with law enforcement agencies and organizations like the Financial Services Information Sharing and Analysis Center.[47] The FDIC shares incident information with the FBIIC, as appropriate. In this way, both the private sector and the U.S. government can see how cyber threats are materializing, and can bring appropriate defensive resources to bear. This information sharing has been effective in helping banks defend against threats arising out of geopolitical tensions this year.

FHFA Capital Rules:

4. The Federal Reserve's recent efforts to rein in inflation through interest rate hikes have resulted in unrealized losses which have affected community banks' tangible book values but not their regulatory capital levels. The Federal Housing Finance Agency's policy on tangible capital—which is inconsistent with the federal banking regulators— limit access to Federal Home Loan Bank advances to banks that have negative tangible book values even though they are considered "well capitalized" by the regulatory agencies.

What steps are the regulators taking to ensure that reasonable investments that community banks made in US Treasuries that have resulted in unrealized losses do not become a supervisory crisis?

Response

The Federal banking agencies are engaging directly with banks that have significant levels of unrealized losses to ensure that they have appropriate plans in place to manage their capital and liquidity positions. Even though U.S. Treasury securities have no credit risk, a bank may still recognize a loss resulting from recent increases in interest rates should the bank need to sell its U.S. Treasury securities to meet liquidity needs.

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[47] For information on the Financial Services Information Sharing and Analysis Center available at https://www.fsisac.com/.

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Are regulators taking steps to work with banks that are impacted? Is there a regulatory process in place so that a bank can seek a waiver from the FHFA's tangible capital rule?

Response

Yes, the Federal banking agencies are working directly with each impacted bank. The FDIC will consider any waiver request submitted on a case-by-case basis.

Have the regulators engaged with FHFA to prevent this from becoming a liquidity issue that further puts pressure on the already fragile housing market?

Response

The Federal banking agencies have engaged with the FHFA. However, the tangible capital rule is a regulation put in place by the FHFA and we would defer to the FHFA on their regulation.

S.2155:

5. I think that the pandemic really showed that our bipartisan Economic Growth, Regulatory Relief, and Consumer Protection Act struck the right balance.

During the pandemic we saw financial institutions able to step up and serve their communities, with the balance sheets and protections to withstand the economic crisis that came with it.

In Montana, our community banks and credit unions stood up to make programs like PPP work for small businesses on their Main Streets and keep folks employed.

Do you think the banking and credit union sectors you oversee are safe and secure right now?

Response

I will defer to the National Credit Union Administration regarding the credit union sector. Since my testimony, the performance data for the Third Quarter 2022 Quarterly Banking Profile

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was published.[48] The banking industry performance continues to reflect positive results. Key banking industry metrics remain favorable at this time. Loan growth continued, net interest income grew and asset quality measures remain favorable, despite a rise in early delinquencies. Further, the industry remains well-capitalized and highly liquid. The number of institutions on the FDIC's "Problem Bank List" increased by two from the previous quarter to 42 banks, but still remains near record low levels. No banks failed during the third quarter.

Where are there areas that give you concern?

Response

Managing credit risk and interest rate risk during this challenging time in our economy, particularly during historic levels of inflation, will challenge all banks in the near term, including community banks. Community banks will also continue to face challenges in being able to keep up with technology and staying relevant in a world that is increasingly becoming digitized, although the personal touch with consumers and small business has continued to be identified as a defining factor in what sets community banks apart from their competitors. Additionally, community banks, particularly those in rural communities, continue to experience succession management challenges in attracting and maintaining talent to operate the banks in the future.

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[48] *FDIC Press Release for the Third Quarter 2022 QBP*. See, https://www.fdic.gov/news/press-releases/2022/pr22082.html.

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Expanding Banking Access Minority Communities

1. How is the FDIC increasing access to banking services for Latino and Hispanic families, including non-English speaking families and those families earning under $50,000/year?

Response

The FDIC is committed to expanding economic inclusion, including by ensuring that all Americans have access to affordable and sustainable products and services from insured depository institutions. An account relationship with a financial institution is fundamental to participation in the banking system. With a quality banking relationship, consumers can build savings and qualify for credit to meet their goals, such as owning a home or starting a business.

The FDIC's outreach to the Latino and Hispanic community is motivated by the importance of increasing access to financial education and banking services for the U.S. Hispanic population, including non-English speaking families. Similarly, the FDIC's work in advancing economic opportunities for low- to moderate-income (LMI) communities include activities that promote upward mobility for lower-income earning households, to include those earning under $50,000 per year.

For example, the FDIC launched its national #GetBanked[26] campaign campaign in Spanish with the goal of motivating unbanked households in targeted geographical areas (i.e., Hispanic minority communities and LMI areas) to open accounts with insured banks to expand their access to banking services.

Throughout 2022, the FDIC worked with banks, federal and state bank regulators, and community stakeholders to conduct webinars to extend banking and educational resources to Hispanic and Latino audiences. Important event topics included affordable credit, access to financial services, account/banking access, financial education and homeownership opportunities.

Additionally, the FDIC's Money Smart financial education resources offer technical assistance, financial education training, and ongoing support to national and regional intermediaries who work with communities of color and economically disadvantaged groups. Further efforts of expanding access to minority communities consists of disseminating FDIC Economic Inclusion resources in English and Spanish, including:

[26] Information on the #GetBanked initiative is available in Spanish at https://www.fdic.gov/getbanked-esp/

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- Money Smart[27] financial education programs
- FDIC #GetBanked Initiative
- FDIC Consumer News[28]
- FDIC Spanish Website[29]
- How Money Smart Are You?[30] in Spanish (Developed 14-game suite in 2022)

2. How is the FDIC increasing access to banking services for Native American and Southeast Asian American families, particularly those in underserved rural, urban communities and those earning under $50,000/year?

Response

The FDIC's Economic Inclusion Strategic Plan focuses on reaching the most underserved segments of the population including but not limited to rural, Native American, Asian American and Native Hawaiians/Pacific Islanders households, and households from all segments with incomes under $50,000 a year.

To accomplish this, the FDIC relies on national and local research shedding light on the specific challenges facing each of these segments in accessing and taking full advantage of the banking system. For example, the biennial FDIC National Survey of Unbanked and Underbanked Households (Household Survey)[31], administered in partnership with the U.S. Census Bureau, collects information on bank account ownership; use of prepaid cards and nonbank online payment services; use of nonbank money orders, check cashing, and money transfer services; and use of bank and nonbank credit. Survey estimates are available across many characteristics of U.S. households, including family income, education, age group, race and ethnicity, disability status, and metropolitan and nonmetropolitan status.

The FDIC helps banks to connect with community-based organizations that serve underserved populations and assists them in identifying potential models of collaboration, products and services that might help meet the banking needs of those populations. One way the FDIC assists banks in the adoption of promising practices to meet the needs of unbanked and underbanked consumers and entrepreneurs is by convening local, regional and national events that showcase programs, products and services for rural, low income, and Black, Indigenous and

[27] Available at https://www.fdic.gov/resources/consumers/money-smart-esp/learn-money-smart/index.html.
[28] Available at https://www.fdic.gov/resources/consumers/consumer-news/esp/index.html.
[29] Available at https://www.fdic.gov/espanol/.
[30] Available at https://playmoneysmart.fdic.gov/games.
[31] See, the 2022 Household Survey website at https://www.fdic.gov/analysis/household-survey/.

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People of Color (BIPOC) communities. The FDIC Community Affairs Events page[32] lists past and upcoming events targeted to organizations serving tribal, rural, and low-income communities. Each of these events draws tens or hundreds of attendees interested in establishing collaborations to address different Economic Inclusion topics in specific geographies. The FDIC plays an important role in facilitating connections between organizations that ultimately enable new or enhanced access to banking services for the targeted communities. Further, the FDIC's free financial education resource Money Smart for Adults[33] is available in English, Chinese, Korean, Spanish, Vietnamese, Braille and Large Print. The FDIC Money Smart Alliance members list,[34] which is available at the FDIC.gov website and updated regularly, indicates the languages of the Money Smart curricula offered by each of the Alliance members.

[32] Available at https://www.fdic.gov/resources/consumers/events/index.html.
[33] The Money Smart webpage can be found at https://www.fdic.gov/resources/consumers/money-smart/index.html.
[34] The list is available at https://www.fdic.gov/resources/consumers/money-smart/money-smart-alliance/alliance-members-list.html.

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1. The recent news about FTX underscores the necessity of robust regulation in our financial markets, especially for novel financial instruments like digital assets and cryptocurrencies that have largely operated freely and with impunity. I understand that this industry touches all four of your agencies differently, and jurisdictional lines are still being drawn. Ultimately it is up to Congress to create a stable regulatory environment for the digital asset industry and to define those lines. However, in the meantime, what are your agencies doing to safeguard everyday Americans and the financial system against a crypto-connected crisis, as we saw with FTX?

Response

The FDIC examines supervised institutions for safety and soundness and consumer protection through a robust supervisory process. The FDIC has taken several actions in light of the rapidly evolving nature of crypto assets and because risks of this area are not well understood given the limited experience with these new activities. With regard to FDIC-supervised institutions and FDIC supervisory authorities, on April 7, 2022, the FDIC issued Financial Institution Letter FIL-16-2022, Notification of Engaging in Crypto-Related Activities,[49] to address FDIC-supervised institutions' engagement in crypto asset-related activities. The FDIC requested that all FDIC-supervised institutions that are considering engaging in, or are already engaged in, crypto asset-related activities to notify the FDIC and to provide all necessary information that would allow the FDIC to engage with the institution to assess the safety and soundness, consumer protection, anti-money laundering/countering the financing of terrorism (AML/CFT), and financial stability risks and provide supervisory feedback. The FDIC established this case-by-case approach to gain a better understanding of the risks of the specific crypto-asset related activities by FDIC-supervised banks. Also, in addition to supervisory authorities related to insured institutions, the FDIC also has authorities related to misrepresentations of deposit insurance. On August 19, 2022, the FDIC issued letters demanding five companies and their officers, directors, and employees cease and desist from making false and misleading statements about FDIC deposit insurance and take immediate corrective action to address these false or misleading statements.[50] Based upon evidence collected by the FDIC, each of these companies made false representations stating or suggesting that certain crypto–related products are FDIC–insured or that stocks held in brokerage accounts were FDIC–insured. All of these letters resulted in the removal of the misrepresentations. Most

[49] See: https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html.
[50] See: https://www.fdic.gov/news/press-releases/2022/pr22060.html.

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recently, on January 3, 2023, the FDIC, along with the Board of Governors of the Federal Reserve System (Federal Reserve) and the Office of the Comptroller of the Currency (OCC), released a Joint Statement on Crypto-Asset Risks to Banking Organizations. This statement enumerated several risks posed by crypto-assets that banking organizations should be aware of, including significant volatility in crypto-asset markets; risk management and governance practices in the crypto-asset sector exhibiting a lack of maturity and robustness; and inaccurate or misleading representations or disclosures by crypto-asset companies, among others. The FDIC will continue to provide oversight and monitor potential risks posed by crypto-asset related activities to supervised institutions.

2. What have you been doing to educate firms and consumers under your jurisdiction about the risks associated with these entities, especially those operating offshore?

Response

The FDIC's core mission is to maintain stability and public confidence in the nation's financial system. In support of this mission, the FDIC insures deposits (within regulatory limits) in the event insured institutions fail and examines and supervises financial institutions for safety and soundness and consumer protection. The FDIC plays an important role in the protection of consumers and depositors as the primary federal regulator of state non-member banks and state savings associations. In these roles, the agency is concerned about the risks of consumer confusion or harm arising from crypto assets offered by, through, or in connection with insured depository institutions. Inaccurate representations about deposit insurance by non-banks, including crypto companies, may confuse customers and cause them to mistakenly believe they are protected against any type of loss. Moreover, customers may not understand the role of the bank as it relates to the activities of the non-bank, or the speculative nature of certain crypto assets. Risks are elevated when a non-bank entity offers crypto assets while also purporting to offer an insured institution's deposit products.

As a result of these concerns, to date the FDIC has taken certain actions, as described below, to advise the industry and help to educate the public. The FDIC has indicated that as it gains greater experience and understanding of the risks of these activities, it would expect to issue broader guidance with the other federal banking agencies to the banking industry.

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Advisory to Insured Depository Institutions

Advisory to FDIC-insured institutions Regarding Deposit Insurance and Dealings with Crypto Companies (FIL-35-2022 July 29, 2022)[51]: The FDIC issued an advisory to all FDIC-insured institutions to address certain misrepresentations about FDIC deposit insurance by some crypto companies. The advisory reminds FDIC-insured institutions of the need to be aware of how FDIC insurance operates and the need to assess, manage, and control risks arising from third-party relationships with crypto companies, including confirming and monitoring that these companies do not misrepresent the availability of deposit insurance.

Guidance to FDIC-Supervised Institutions

Notification and Supervisory Feedback Procedures for FDIC-Supervised Institutions Engaging in Crypto-Related Activities (FIL-16-2022, April 7, 2022)[52]:The FDIC issued a financial institution letter to all FDIC-supervised institutions to address engagement in crypto asset-related activities. The letter contains a description of some of the crypto asset-related risks about which the FDIC is concerned, including safety and soundness, consumer protection, and financial stability. The letter also requests that FDIC-supervised institutions considering engaging in, or are already engaged in, crypto asset-related activities notify the FDIC and provide information that would allow the FDIC to engage with the institution to assess the safety and soundness, consumer protection, anti-money laundering/countering the financing of terrorism (AML/CFT), and financial stability risks and provide supervisory feedback.

Joint Statement on Crypto-Asset Risks to Banking Organizations (January 3. 2023)[53]
This joint statement of the FDIC, OCC and Federal Reserve enumerated several risks posed by crypto-assets that banking organizations should be aware of, including significant volatility in crypto-asset markets; risk management and governance practices in the crypto-asset sector

[51] See, https://www.fdic.gov/news/financial-institution-letters/2022/fil22035.html.
[52] See, https://www.fdic.gov/news/financial-institution-letters/2022/fil22016.html.
[53] See, https://www.fdic.gov/news/press-releases/2023/pr23002.html.

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exhibiting a lack of maturity and robustness; and inaccurate or misleading representations or disclosures by crypto-asset companies, among others.

Communication to the Public

The FDIC has provided information through a variety of media to educate the public about the nature and some of the risks associated with crypto assets, and continues to collaborate with other government entities on advice to the public:

Fact Sheet: What the Public Needs to Know About FDIC Deposit Insurance and Crypto Companies (PR-58-2022, July 29, 2022): The FDIC issued a press release announcing the posting of the Deposit Insurance Fact Sheet to the FDIC's webpage to clarify for customers of non-bank entities, such as crypto companies, and the public generally, that deposit insurance does not cover non-deposit products, including crypto assets.

Remarks by FDIC Acting Chairman Martin J. Gruenberg at the Brookings Institution on The Prudential Regulation of Crypto-Assets (October 2022) FDIC Chairman Gruenberg delivered remarks on the prudential regulation of crypto assets during which he discussed some risks associated with crypto asset related activities. In addition, he indicated that from the perspective of a banking regulator, before banks engage in crypto asset related activities, it is important to ensure that: (a) the specific activity is permissible under applicable law and regulation; (b) the activity can be engaged in a safe and sound manner; (c) the bank has put in place appropriate measures and controls to identify and manage the novel risks associated with those activities; and (d) the bank can ensure compliance with all relevant laws, including those related to AML/CFT, and consumer protection.

FDIC Consumer News (August 2022)[54] *and Podcast (Episode 24, November 29, 2022.*[55] The FDIC Consumer News published an article The Importance of Deposit Insurance and Understanding Your Coverage that made clear FDIC deposit insurance does not cover crypto assets. In addition, the FDIC posted on its website a podcast titled Deposit Insurance Explained – Part Two which discusses the risks the public needs to keep in mind when it comes to deposit

[54] https://www.fdic.gov/resources/consumers/consumer-news/2022-08.html.
[55] https://www.fdic.gov/news/podcasts/.

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insurance, including a discussion about companies that misrepresent their products as FDIC-insured and a reminder that federal deposit insurance does not apply to crypto assets.

The U.S. Department of the Treasury Financial Literacy and Education Commission:[56] The FDIC is an active member of the Financial Literacy and Education Commission, which coordinates the national strategy on financial education, and the financial education website MyMoney.gov.[57] Among other things, the Commission is reviewing opportunities to coordinate and promote consumer education efforts on crypto assets. The FDIC educates consumers and communities about deposit insurance at FDIC.gov.

3. Banking deserts drive everyday Americans to use predatory lending services and other firms that take advantage of the lack of options available in communities. What steps are you taking to ensure that folks that live in banking deserts have access to basic banking services?

Response

Deposit accounts at federally insured depository institutions are covered by deposit insurance and other consumer protections. Ownership of an account at a federally insured depository institution provides households with a safe place to keep deposits and to save for emergency and long-term needs, and it facilitates households' financial transactions. Having a bank account and a banking relationship can also facilitate households' access to responsible, affordable credit, and such access can help households build their credit history. For this reason, the FDIC has been focused on expanding participation in the mainstream banking system.

For example, the FDIC started its #GetBanked[58] initiative, which is a multi-year effort to motivate unbanked consumers to begin a banking relationship and open an account. The initiative kicked off near the beginning of the pandemic in 2020, when the first round of Economic Impact Payments (stimulus payments) were released. The FDIC wanted to increase

[56] Information on the Financial Literacy and Education Commission is available at https://home.treasury.gov/policy-issues/consumer-policy/financial-literacy-and-education-commission.
[57] See, https://www.mymoney.gov/.
[58] Information on #GetBanked is available at https://www.fdic.gov/getbanked/index.html.

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messaging about the importance of getting banked so that more Americans, particularly those in low- and moderate-income communities who were hardest hit, could access government resources that could help sustain their households during the pandemic.

As part of the multi-year initiative, the FDIC launched a three-month public awareness advertising campaign pilot in April 2021 to motivate unbanked and underbanked consumers in two metropolitan statistical areas (MSA), Atlanta and Houston, to join the banking system. A second three-month pilot was launched in February 2022 in three MSAs – Dallas, Detroit, and Los Angeles. The FDIC leveraged the 2019 FDIC National Survey of Unbanked and Underbanked Households data to identify these pilot cities/ Metropolitan Statistical Areas (MSA) , based on: (1) the size of unbanked populations throughout the country; (2) the presence of community organizations who serve unbanked populations and financial institutions that participate in an FDIC Alliance for Economic Inclusion or other local economic inclusion roundtable; (3) high broadband access; and (4) the presence of FDIC Community Affairs staff nearby to engage partners in the respective MSAs.

In addition, the FDIC's #GetBanked[59] webpage went live in 2021 and includes information and resources promoting the opportunities to find a bank and open a bank account online, including links to lists of affordable accounts that can be opened online through Bank On and the Independent Community Bakers of America. FDIC collaborated with multiple Federal agencies to increase messaging regarding the importance of having a bank account and encouraging the general public to visit our webpage to open a bank account to receive government payments and other direct deposits. For example, the IRS included links to our #GetBanked page on its social media posts and multiple pages of its website, particularly its "Where's My Refund" and "Get Your Refund Faster" pages, and the "Child Tax Credit Update Portal". They also issued a Frequently Asked Questions about Economic Impact Payments which referenced the FDIC's #GetBanked webpage. We also partnered with other Federal agencies who communicate directly with consumers, such as the Consumer Financial Protection Bureau, U.S. Department of Treasury's Bureau of Fiscal Services, and Federal Communications Commission.

[59] See, http://www.fdic.gov/getbanked.

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Finally, the FDIC has been involved in 30 account access events conducted in 2022 (through November) that focused on affordable account access to unbanked and underbanked communities throughout the country.

4. What are your agencies doing to promote responsible small-dollar lending by the financial institutions you regulate? Please describe how your agencies are measuring the effectiveness of your efforts to date and share supporting data if available.

Response

The FDIC recognizes the important role that responsibly offered small-dollar loans can play in helping customers meet their ongoing credit needs. As such the FDIC, along with the OCC, FRB, NCUA issued "Interagency Lending Principals for Offering Responsible Small-Dollar Loans"[60] in May 2020 to encourage institutions to offer small-dollar loans with certain characteristics including:

- A high percentage of customers successfully repaying their loans in accordance with original loan terms, which is a key indicator of affordability, eligibility, and appropriate underwriting;
- Repayment terms, pricing, and safeguards that minimize adverse customer outcomes, including cycles of debt due to rollovers or reborrowing; and
- Repayment terms and program structures that enhance a borrower's financial capabilities.

In addition, FDIC Community Affairs staff conduct multiple events to encourage adoption of small dollar and credit building solutions in various markets. Upcoming and past events on those subjects, can be found on the FDIC Community Affairs Events webpage.[61]

[60] See, *FDIC's Press Release on Interagency Guidance for Responsible Small Dollar Loans,* https://www.fdic.gov/news/financial-institution-letters/2020/fil20058.html
[61] See, https://www.fdic.gov/resources/consumers/events/.

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1. In its current form, the Agencies' proposed rule requires banks utilizing Strategic Plans to be assigned new Assessment Areas based upon where specific lending activities already occur, concentrating competition among many lending institutions, including nonbanks, for the same loans and creating the unintended consequence that focused efforts on arbitrarily chosen lending activities, instead of allowing for innovation and creativity in meeting the most critical financial needs of a community. Ultimately, providing loans or community development investments and services only to the most heavily populated areas will divert financial and human capital from less densely populated areas. This outcome is completely contradictory to the goals of serving bank deserts - one of the goals the Agencies claim is a primary focus of CRA modernization. Are the Agencies willing to fix the discrepancies identified above, and preserve the Strategic Plan Option in its current form as part of the final rule, to ensure the current goals and objectives that meet communities' needs and accommodate an individual bank's capabilities due to the superior community benefit the Plan provides and the ability to create innovative investments while promoting regulatory and public engagement? Banks that collaborate under the Strategic Plan with their prudential regulators and community stakeholders to serve those communities as intended under the Act, have achieved great outcomes, and have been recognized by you, their prudential regulators, earning repeated Outstanding CRA ratings.

<u>Response</u>

The NPR proposes to retain the CRA strategic plan option as an alternative evaluation method to give banks flexibility to meet their CRA obligations in a manner that is tailored to community needs and opportunities as well as their own capacities, business strategies, and expertise.

The NPR also proposes to introduce more specific criteria to ensure that all banks are meeting their CRA obligation to serve low- and moderate-income individuals and communities. This approach is intended to ensure that banks approved to be evaluated under a CRA strategic plan option would have the same assessment area requirements as other banks and would submit plans that include the same performance tests and standards that would otherwise apply unless the bank is substantially engaged in activities outside the scope of these tests. In seeking approval for a plan that does not adhere to requirements and standards that are applied to other banks, the plan would be required to include an explanation of why the bank's different standards would be more appropriate in meeting the

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credit needs of its communities. The agencies are reviewing and considering the comments received on this optional evaluation method.

2. The Strategic Plan allows the bank and the regulator to work together if alterations to the plan are required, allowing the bank to optimally serve their communities, especially those that include low- and moderate-income populations, as well as investing in underserved areas like banking deserts, communities the regulators also seek to serve in CRA modernization. Why are the Agencies proposing a one-size-fits-all approach for Strategic Plans that will create a purely formulaic approach to fulfill the requirements of the Community Reinvestment Act, which will deprive some banks of the essential flexibility to meet the unique development needs of many underserved communities in which they operate, and for which the Agencies have historically rewarded creative and innovative CRA approaches to serve those same communities?

Response

The agencies do not intend the strategic plan option to be a one-size-fits-all approach. A strategic plan should provide justification for why it is necessary for their business model and strategy. In addition, banks wanting to be evaluated under a strategic plan should incorporate how the bank's activities help to meet the credit needs of low- and moderate-income individuals and communities whenever possible. The NPR would require banks that elect the strategic plan evaluation to provide a justification for why the applicable performance tests and standards are not appropriate for the bank, but does not prohibit flexibility. For example, banks would be given flexibility to set different metrics from those that would otherwise be applicable if a bank is substantially engaged in activities outside of the scope of the standard performance tests

3. The Agencies' efforts to address climate change through financial regulation have significantly increased in recent years. Contrary to research from the Federal Reserve Bank of New York, many regulators assert that the effects of climate change pose an existential risk to banks. While not directly mandating climate-related policies for banks, statements and principles issued by the Agencies seem to heavily insinuate that supervised banks need to incorporate certain efforts against climate change or else be subject to unwanted regulatory attention.

a. Will you provide an example of a U.S. financial institution that failed due to climate change?

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Response

To date, no U.S. financial institution has failed due to climate change. The financial system has always had severe weather events to contend with and, thus far, the banking industry has handled these events well. However, government assistance, insurance proceeds, and other aid were instrumental in reducing the financial consequences of the severe weather events on banks.[37] However, changing climate conditions are bringing with them challenging trends and events that increases in the frequency and severity of extreme weather events. These trends challenge the future resiliency of the financial system and, in some circumstances, may pose safety and soundness risks to individual banks. It is the goal of our work on climate-related financial risk to ensure that the financial system continues to remain resilient despite these rising risks.

b. Given the absence of standardized data reporting on climate risk, how are you confident that the metrics used to measure a bank's climate risk provide an accurate representation?

Response

We understand that more work needs to be done to ensure that the banking industry has availability to robust and reliable data. As such, it is important for regulators to work with the industry and support financial institutions as they develop plans to identify, measure, and manage risks posed by climate change.

c. Will you commit to ensuring that financial institutions with climate-related risk exposure will not be subject to regulatory retaliation until a standardized framework is agreed upon by industry and regulators?

Response

We understand that improvements need to be made with respect to the availability of data and measurement tools. We are working closely with our fellow regulators, as well as the industry, to help resolve this issue. We will continue work with financial institutions in a manner

[37] J. Anderlik; A. Bush; R. Cofer, Jr.; K. Kalser; and J. McGee, "Severe Weather Events and Local Economic and Banking Conditions," (2022), https://www.fdic.gov/analysis/cfr/staff-studies/2022/2022-03.pdf.

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that is flexible enough to allow for change as knowledge is gained, data are developed, and new methodologies and tools are explored.

4. As you know, a bank's ability to provide the products and services customers expect will depend on its ability to leverage the expertise of third-party service providers. Banks that are unable to do so will be face significant challenges competing in the marketplace. In 2020, the FDIC issued a Request for Information (RFI) on a public-private standard-setting partnership intended to reduce the cost, inefficiencies, and uncertainty related to bank onboarding of third-party providers.

  a. What is the status of this project?

  b. If it has been abandoned, why is that the case, particularly in light of the limited resources of community banks?

Response

Beginning in 2020 and during 2021, FDIC staff from the divisions of Risk Management Supervision, Depositor and Consumer Protection, and Legal, as well as others, explored the potential role a public/private standard setting framework could play with community banks' due diligence of technology providers and banks' technology integration. The Request for Information, issued in the summer of 2020, was an initial step in the staff exploration of the concept. By the end of 2021, staff had completed its consideration of the public's comments and review of the potential for standards with respect to banks and third-parties. No additional work specifically involving standard setting was undertaken. The use of third-party technology providers by community banks continues to be an important issue. The FDIC is committed to ensuring that its supervised institutions approach such third-party arrangements appropriately, such as with the expected finalization of interagency guidance on third-party risk management.

5. A bank's decision to return a transaction when the customer has insufficient funds in his account, and to charge an NSF fee, is legal. However, in the FDIC's March 2022 Consumer Compliance Supervisory Highlights and August 2022 Financial Institution Letter, the agency stated that charging multiple NSF fees when a merchant resubmits a transaction against insufficient funds in the customer's account could be an "unfair" act or practice under section

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5 of the Federal Trade Commission Act. To conclude that an act or practice is unfair, the FDIC must make a finding that the act or practice "is not reasonably avoidable by consumers." But customers have ample opportunity to avoid multiple NSF fees. Banks notify their customers whenever an NSF fee is assessed and give customers multiple options to check account balances through online banking and text alerts, so customers can replenish their accounts and avoid receiving multiple NSF fees. How is charging multiple NSF fees for represented transactions not "reasonably avoidable by consumers"?

6. In or around 2021, examiners—without warning—began concluding that banks' NSF disclosures were not clear, and the agency cited banks for a "deceptive" act or practice under Section 5 of the Federal Trade Commission Act. In essence, the FDIC established new disclosure standards for NSF fees without initiating rulemaking.

    a. Do you intend to initiate rulemaking to establish new disclosure standards for NSF fees?

    b. Will you commit to following the Administrative Procedure Act—and initiating rulemaking—the next time the FDIC seeks to impose a new standard on banks?

Combined Response for Questions 5 and 6

As you may know, FDIC consumer compliance examinations are risk-focused[38] and do not fully review all aspects of a financial institution's practices at each examination. Beginning in 2020, several FDIC supervised institutions were subject to class action litigation related to this issue where consumer harm was identified. Consequently, when higher consumer harm risk was identified, the issue was reviewed during regularly scheduled consumer compliance examinations.

To proactively provide supervised institutions and the public with information and observations related to the FDIC's consumer compliance supervision activities, the FDIC regularly publishes *Consumer Compliance Supervisory Highlights*, which include high-level overviews of consumer compliance issues identified through the FDIC's supervision of state non-member banks and thrifts. The Spring 2022 issue of *Consumer Compliance Supervisory*

[38] FDIC Compliance Examination Manual, pg. II – 1.1 (Overview of Compliance Examinations) – "Risk-focusing involves using information gathered about a financial institution to direct FDIC examiner resources to those operational areas where compliance errors present the greatest potential risks of having a negative impact on bank customers, resulting in consumer harm…"

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Highlights,[39] published in March 2022, included an article, based on supervisory findings from 2021, discussing how disclosure and fee practices for re-presentments may result in heightened risk of violations of Section 5 of the Federal Trade Commission Act ("Section 5"). In August 2022, the FDIC issued Supervisory Guidance on Multiple Re-Presentment NSF Fees ("Supervisory Guidance") to FDIC-supervised institutions to address certain consumer compliance risks associated with assessing multiple NSF fees arising from the re-presentment of the same unpaid transaction and to share the FDIC's supervisory approach when a violation of law is identified, as well as expectations for full corrective action.[40]

Violations cited by the FDIC related to banks' assessing multiple NSF fees arising from the re-presentment of the same unpaid transaction are based on the application of longstanding and well-established standards under Section 5 for determining whether a practice is "deceptive." Financial institutions are required to disclose their fees in a manner that avoids deceiving their customers about how fees may be incurred. This is not a new requirement, and the FDIC has not prescribed a particular form or manner that financial institutions must use in the disclosure of their account fees.

FDIC examiners have identified instances where financial institution disclosures were either silent or vague on the possibility of customers incurring multiple NSF fees if a check or ACH transaction is presented multiple times. In those cases, examiners have cited violations of law, as these practices have been determined to meet the standard as a "deceptive" practice under Section 5. Without advance notice of a financial institution's practice, customers may have difficulty avoiding multiple NSF fees or may not have sufficient information to understand fees that may be charged as part of a financial institution's account services.

Many financial institutions have revised their practices by reversing or refunding NSF fees charged after the initial presentment of the item, or not charging NSF fees if they are not confident they can identify re-presented transactions. Financial institutions have also amended their disclosures, and provided updated disclosures to all new and existing customers, so as to let them know that in the future NSF fees would be charged for subsequent re-presentments.

Your question also makes reference to the potential for these practices to be "unfair" under Section 5 of the FTC Act. While the FDIC has not reached such a conclusion and has not cited this practice as unfair, the FDIC has identified risks that charging multiple NSF fees for re-presented transactions could be determined to be unfair, depending on the specific facts and circumstances. For instance, if a bank were to charge a NSF fee for a re-presented transaction

[39] https://www.fdic.gov/regulations/examinations/consumer-compliance-supervisory-highlights/documents/ccs-highlights-march2022.pdf.
[40] https://www.fdic.gov/news/financial-institution-letters/2022/fil22040.html.

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prior to the consumer's receiving any notice of the NSF fee for the initial transaction, then it may be difficult for a consumer to avoid the subsequent NSF fees.

7. There has been considerable discussion about the availability and affordability of insurance as a climate related issue for banks. How is your agency approaching that issue, given that insurance is not regulated at the Federal level, but is an important element for collateral protection for banks?

Response

Issues regarding the future availability and affordability of insurance may be best addressed by the Federal Insurance Office and the National Association of Insurance Commissioners. While insurance currently may cover some or all of the loss associated with severe weather events, policies may over time become more expensive or unavailable to cover losses for a particular geographic area or business activity, particularly if faced with increasing severity and frequency of severe weather events. Banks should, therefore, be careful not to overly rely on insurance, as future policies may not be able to compensate for losses to the same extent, or at the same cost, as they have in the past.

8. CRA stakeholders—including some community advocates—have raised concerns that the interagency CRA proposal is overly partisan, which could result in a rulemaking that will not stand the test of time. Do you believe the durability of a new regulatory framework is important? What can the agencies do to ensure that a modernized regulation will not fall victim to shifting political winds, a result that would not benefit communities, banks, or regulators?

Response

The CRA notice of proposed rulemaking (NPR) represents a unified approach by the three banking regulatory agencies with rulemaking responsibility and builds on significant feedback from stakeholders gathered through prior efforts by the agencies to develop a framework to modernize CRA. A unified and interagency approach is central to the durability of the regulatory approach and has been noted by stakeholders representing both consumer advocates and banking organizations.

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The agencies are following the requirements of the Administrative Procedure Act (APA)[41] by publishing the NPR and providing opportunities for the public to comment. We are analyzing the extensive comments from a wide range of stakeholders, including community groups and industry representatives, as well as having follow-up meetings with the various stakeholders, upon request. The agencies are aiming for a balanced approach in the final rule that fulfills the statutory purposes of the CRA in meeting the convenience and needs of communities, including to low- and moderate-income people, in today's modern banking industry where products and services are delivered through a variety of channels.

9. Many comment letters responding to the interagency CRA proposal expressed concern about the complexity of the proposed Retail Lending Test and its associated performance metrics. Is this a concern that you share? Do you believe that the test and its performance metrics would understandable and manageable for community banks—including community banks with assets of only $2 billion that will be considered "large banks" under the proposal?

Response

The agencies propose to use metrics and performance standards to evaluate a bank's lending to low-income and moderate-income borrowers, small businesses and small farms, and low-income and moderate-income neighborhoods in its assessment areas under a new Retail Lending Test. The metrics and performance standards would apply to all large banks. The approach is intended to make a bank's retail lending evaluation more transparent and predictable by specifying quantitative standards for lending consistent with achieving, for example, a "Low Satisfactory," "High Satisfactory," or "Outstanding" conclusion in an assessment area. The agencies would tailor certain features of the Retail Lending Test for smaller community banks, including intermediate banks. By applying the Retail Lending Test to banks of this size, the proposal is intended to improve the clarity, consistency, and transparency of the evaluation of retail lending. The agencies believe retail lending remains a core part of a bank's affirmative obligation under the CRA to meet the credit needs of their entire communities. At the same time, the agencies recognize that, compared to large banks, intermediate banks might not offer as wide a range of retail products and services, have a more limited capacity to conduct community development activities, and may focus on the local communities where their branches are located. The agencies are seeking comment on every aspect of the proposal, including the Retail Lending Test and its associated performance metrics. We will review the diverse perspectives

[41] 5 U.S.C. §§ 551-559.

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and views received through comments submitted and take them into consideration when finalizing the rule.

10. According to the preamble to the proposal, 34% of "large" banks (defined as having assets of $2B or more) would fail the Retail Lending Test in their new Retail Lending Assessment Areas. Numerous times, the proposal states that this is "appropriate" but does not explain the agencies' rationale for proposing performance benchmarks that would represent such a significant shift in CRA ratings. Please explain why the agencies believe it is "appropriate" to set the Retail Lending performance measures at a level where 1/3 of banks would receive an Unsatisfactory rating in their Retail Lending Assessment Areas. Follow-up: CRA performance benchmarks should be rigorous, yet achievable, and the expectation should be that all banks can meet or exceed the established standard—as is the case with all other consumer protection and safety and soundness regulations. Do you agree that artificially high benchmarks could incentivize banks to engage in undue risk taking in order to comply with the regulation's performance standards?

Response

The NPR proposes a set of metrics that seeks to provide increased consistency and transparency for the CRA evaluation process. The proposed metrics would result in about 90% of all banks continuing to receive passing CRA conclusions on the Retail Lending Test. The Retail Lending test accounts for 45% of the CRA evaluation according to the NPR.

These numbers reflect the application of the proposed metrics to past lending activity. The Retail Lending Assessment Area (RLAA) is a new concept and reflects an effort to evaluate significant lending activities that occur outside of a bank's branch footprint. Establishing these RLAAs would help ensure that the broad range of borrowers would be served by the banks doing business in these areas. Nonetheless, the vast majority of banks would not have any RLAAs under the NPR. Because this is a new concept, and banks have not previously been evaluated on this lending, we would expect performance in these areas to improve significantly for those banks for which RLAAs would be designated under the NPR as banks focus greater attention on servicing the convenience and needs of these communities where they do business. If finalized as proposed, these banks would be able to seek opportunities to address any identified gaps in performance, consistent with safe and sound banking practices.

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We appreciate the detailed and comprehensive comments we received on the NPR and will give this issue careful consideration as we work to finalize the proposal.

11. To address the development and proliferation of digital banking, the proposed CRA rule would create new Retail Lending Assessment Areas (RLAA) where a bank makes more than 100 mortgages or 250 small business loans.

a. Have the agencies analyzed where these new assessment areas would be created? If so, can you share that information with us? [Note: ABA's preliminary analysis using existing HMDA and CRA data finds that most RLAAs would be located in areas currently well-served by banks, which could add to the problem of hot-spots and not encourage CRA activities in underserved areas.]

Response

Under the NPR, the agencies would create new RLAAs to address changes in the banking system in which a significant volume of lending is done outside of a bank's traditional geographic based assessment areas. Under this proposal, a large bank would delineate retail lending assessment areas where it has an annual lending volume of at least 100 home mortgage loan originations or at least 250 small business loan originations in an MSA or nonmetropolitan area of a state for two consecutive years. The proposed approach of designating RLAAs is designed to provide a pathway to evaluate banks in a way that provides parity between banks with different business models. Designating new RLAAs should ensure that, regardless of delivery channel, large banks would be evaluated on their retail lending in the local markets where they conduct significant retail lending business. Establishing these RLAAs would help ensure that the broad range of borrowers would be served by the banks doing business in these areas. Under the proposal, intermediate banks would not be required to designate RLAAs. Additionally, an intermediate bank with more than 50 percent of lending outside of its facility-based assessment areas would be evaluated on outside retail lending area performance under the proposal in the aggregate, while other intermediate banks would only be evaluated on facility-based assessment area performance. As noted in the previous response, the vast majority of banks will not have any RLAAs.

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The agencies continue to review comments and will take the views of all stakeholders into consideration when finalizing the rule.

12. Cost/benefit analysis: The actual benefit to communities and consumers targeted by CRA should be measured against the substantial increase in regulatory burden. How have the agencies determined that the proposal strikes this balance? Are there less burdensome alternatives that could accomplish this objective?

Response

In the Notice of Proposed Rulemaking (NPR), the agencies carefully considered the potential regulatory impact on smaller entities, in accordance with the Regulatory Flexibility Act. This consideration includes description of the projected reporting, recordkeeping, and other compliance requirements of the NPR and significant alternatives considered. In addition, in accordance with the Paperwork Reduction Act, the agencies developed detailed estimates of the collection and reporting burden for provisions of the NPR. This material may be found in Section XXII of the NPR.[42]

From the outset, the agencies intended for the proposals in the NPR to modernize CRA in accordance with the statute while providing greater certainty, tailoring the regulations where appropriate, and minimizing regulatory burden. In several areas of the NPR, the agencies request feedback with respect to the metrics-based approach in the proposal. This reflects the regulators' awareness of potential tradeoffs between providing greater clarity and certainty against the backdrop of additional data collection and reporting requirements. In addition, the agencies note in the NPR that the metrics-based approach would rely to the extent possible on existing data. Moreover, small and intermediate banks are exempt from certain data collection and reporting requirements.

The agencies received a number of comments related to this issue, and will carefully consider feedback received on this important issue to accomplish the rulemaking's policy objectives in a manner that avoids unnecessary burden on banks.

13. Implementation period: The proposed one-year implementation period following publication of a final rule is too short given the complexity of the proposal and we believe a longer period is necessary. One year is not an adequate amount of time for banks to turn

[42] 87 Fed. Reg. 33884, 34006-34015 (June 3, 2022).

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operations over to a new regime of requirements and collect and report the data required for benchmarking and comparisons. Given these significant constraints, will the agencies consider a longer implementation period?

Response

The agencies proposed the implementation dates in the NPR in order to provide banks with a reasonable time period to transition from the current regulations to the proposed regulations for collecting, maintaining, and reporting data; transitioning systems; and establishing policies and procedures necessary for the orderly implementation of a new rule. We have received a number of comments related to the transition period and challenges banks may face in collecting data and implementing systems. We are reviewing and considering these comments as we work to finalize the propose rule.

14. Performance standards: At a June 6 forum sponsored by the Urban Institute, FDIC Chair Martin Gruenberg said the following: "Raise the bar for performance, meaning, what a bank did before to earn an Outstanding or High Satisfactory will not be sufficient. They will have to engage in more lending activity to earn the recognition. The goal is more lending to more low- to moderate-income communities." Banks already make great efforts to serve their communities through CRA, but Mr. Gruenberg's statement implies that banks are not doing enough. Why do the agencies believe the bar needs to be raised for CRA performance? A 125% threshold for Outstanding performance will practically eliminate the opportunity for banks with significant market share in any market to achieve an Outstanding rating in that market. How and why were the thresholds established?

Response

We understand that many banks already make significant efforts to serve their communities through the CRA. As noted in the preamble, the agencies propose to set the market multiplier at 125 percent for an "Outstanding" conclusion. A bank may also attain an "Outstanding" conclusion by hitting the Community benchmark, without regard to the activity of other lenders in the area. The Market benchmark sets a threshold in excess of the average of all local lenders, while still being an attainable target for many better performers. The agencies recognize that many banks, especially large banks, frequently employ dedicated CRA teams with strong relationships to the community to ensure that the bank appropriately identifies and helps to meet community credit and community development needs. Thus, the agencies propose to set

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the threshold for an "Outstanding" conclusion at a point that is attainable for banks that are actively working and making choices to be leaders in helping to meet community credit and community development needs. At the same time, the agencies propose not to set the "Outstanding" conclusion threshold too low to ensure that an "Outstanding" conclusion is awarded only to banks that have demonstrated an exceptional level of performance. The agencies are reviewing the comments and will consider the views of all commenters when finalizing the proposal.

15. Thresholds: While we understand the agencies have given some background to the reasoning for the specific thresholds (p 33919), we believe the proposed mortgage and small business loan thresholds for delineating retail lending-based assessment areas need to be increased or include other modifications. As proposed, many banks would have increased assessment areas far beyond current requirements (e.g., one institution in our membership would have a 700% increase in assessment areas). As a possible unintended consequence, these low thresholds may lead to reduced lending, leaving borrowers with few options.

a. Have the agencies considered the possible consequences of banks pulling out of certain possible assessment areas due to the impracticality of adding additional countywide MSAs due to low volume thresholds?

b. Have the agencies considered alternatives to the proposal including on national out of footprint area?

Response

As mentioned before, under this proposal, a large bank would delineate retail lending assessment areas where it has an annual lending volume of at least 100 home mortgage loan originations or at least 250 small business loan originations in an MSA or nonmetropolitan area of a state for two consecutive years. To determine these thresholds, the agencies considered what levels would appropriately align with the amount of lending typically evaluated in a facility-based assessment area. The agencies also considered what threshold levels would result in a substantial percentage of loans that are outside of facility-based assessment areas being evaluated within a retail lending assessment area, as the agencies believe retail lending should be evaluated within a local context wherever feasible, based on a sufficient volume of loans and the size and business model of the bank. Under this approach, the vast majority of banks will not

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have any RLAAs. The agencies continue to review comments and will take the views of all stakeholders into consideration when finalizing the rule.

16. Retail lending test: Several areas of the proposal do not fully account for the transition of the industry toward digital delivery channels, especially for banks that primarily or exclusively serve customers through digital channels. For example, it is unclear how a digital bank could pass the Retail Services and Products Test given the test's focus on branch distribution. Additionally, the Retail Lending Test is tied to specific geographies, but in practice, digital lending is not related to any specific geography, meaning many digital banks will be scrutinized under the RLT simply because they happened to make 100 mortgage or 250 small business loans in a given geography. Will the agencies consider further tailoring the rule to account for digital banks?

Response

One of the objectives of the NPR is to update the CRA regulations to adapt to changes in the banking industry, including the expanded role of mobile and online banking. As noted earlier, changes in the banking system mean that many loans are now being made outside of a bank's traditional geographic based assessment areas envisioned when CRA was enacted 45 years ago. The Retail Lending Test would require that large banks delineate retail lending assessment areas where a bank has concentrations of home mortgage and/or small business lending outside of its facility-based assessment areas. In order to ensure that banks are evaluated on most of the loans they make to low- and moderate-income communities and small businesses and small farms, CRA modernization needs to capture lending by banks that primarily operate digitally in local communities.

The Retail Services and Products test measures a large bank's branch distribution as well as its digital delivery system (optional for those banks under $10 billion). According to the NPR and current practice, examiners would be expected to exercise their judgement in determining how to weight these elements based on a bank's business model and focus. The agencies continue to review comments and will take the views of all stakeholders into consideration when finalizing the rule.

17. Strategic plans: The strategic plan option in the proposal seems less flexible than under the current CRA framework, and the agencies seem to be backing away from an option they have

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often asked banks to consider under the current framework. The proposal contains very little information about when a strategic plan might warrant flexibility with respect to the otherwise applicable standards and does not detail the extent of the available flexibility. Since the proposed strategic plan option would not be much different from evaluation under the relevant performance test, will the agencies provide some transparency on how the strategic plan option will maintain flexibility for banks that do not fit into the conventional retail framework, such as digital banks and banks focused on consumer lending?

Response

The strategic plan option was originally developed, and retained within the proposal, with a focus on banks that do not fit the conventional retail framework. While the agencies would require banks that elect a strategic plan evaluation to provide a justification for why the applicable performance tests and standards are not appropriate for the bank, the intent is not to prohibit a bank from incorporating measurable goals in their strategic plan that are in alignment with the bank's business model and strategy. The agencies continue to review the comments received on this option and will consider such when finalizing the rule.

18. Indirect lending: In an indirect lending scenario, banks have little contact and little discretion targeting LMI borrowers. Have the agencies considered excluding indirect auto loans, or other types of indirect financing including equipment, RV, marine, etc., from the auto lending evaluation?

Response

The proposal includes several requests for feedback regarding the treatment of automobile loans. Regulators will weigh feedback regarding the consideration of automobile loans in the context of consumer lending and are interested in commenters' analysis of automobile lending under the proposed retail lending test framework. As the NPR indicates, the regulators have asked questions regarding a range of options for the evaluation of automobile lending, such as qualitative as opposed to quantitative analysis, as well as alternative data collection and reporting requirements needed to support evaluation of bank performance.

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19. More than half American consumers are finding it difficult to meet emergency financial needs according to a recent GAO study. Over the last decade, there have been 19 regulatory actions pertaining to small dollar lending, many of which have all but killed the small dollar market for depository institutions and pushed consumers to the less regulated and less supervised alternative lending markets like payday lenders. As noted by the GAO, many depository institutions are hesitant to dedicate the resources needed to adequately develop small-dollar products that will help consumers meet their monetary shortcomings.

a. Do you believe there is a need for small dollar loan product offered by highly regulated depository institutions?

b. Do you believe it is important for the banking agencies to coordinate small dollar lending policies? What are you doing to facilitate that?

<u>Response</u>

The FDIC recognizes the important role that responsibly offered small-dollar loans can play in helping customers meet their ongoing credit needs. As such the FDIC, along with the OCC, Federal Reserve and NCUA, issued "Interagency Lending Principals for Offering Responsible Small-Dollar Loans"[43] in May 2020 to encourage institutions to offer small-dollar loans with certain characteristics including:

- A high percentage of customers successfully repaying their loans in accordance with original loan terms, which is a key indicator of affordability, eligibility, and appropriate underwriting;
- Repayment terms, pricing, and safeguards that minimize adverse customer outcomes, including cycles of debt due to rollovers or reborrowing; and
- Repayment terms and program structures that enhance a borrower's financial capabilities.

[43] See, *FDIC's Press Release on Interagency Guidance for Responsible Small Dollar Loans,* https://www.fdic.gov/news/financial-institution-letters/2020/fil20058.html

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Imposing Liability on Banks for Authorized P2P Payments to Scammers

20. There have been rumors that the CFPB is planning to shift liability for P2P payments that consumers make to a scammer. Obviously, scammers will profit from such a policy because, armed with an official government document, they will be able to induce people to pay them by telling them there is no risk in sending the money –even if the circumstances are suspicious. However, banks, unlike the consumer, would have no insight into the transaction to be able to stop it. Are you concerned about: The impact on bank safety and soundness given banks' inability to identify or stop the fraud and the size of potential fraud losses banks would incur? The impact on competition if small banks in particular cannot offer the product because the risk of loss is too much to bear? The harm to consumers if banks begin charging for these very popular services, limiting access to the product, or adjusting the model to reduce the potential for fraud loss (i.e., imposing delays in consumer access to the money or limiting transaction amounts or the number of transactions), which will reduce the value or appeal of P2P services?

Response

The CFPB has rulemaking and interpretative authority under Regulation E. The FDIC is tracking this issue closely. Should the CFPB take action in this area, the FDIC will review that action and determine next steps within the scope of its authority.

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1. As mentioned in your testimony, the FDIC is working to secure the DIF balance to the statutory minimum after the increase of insured deposits from 2020. What projections do you have for the first quarter of 2023 on rate schedules? Do you believe that the FDIC can assess market movements adequately for the next quarter?

Response

On October 18, 2022, the FDIC Board adopted a Final Rule to increase initial base deposit insurance assessment rate schedules uniformly by 2 basis points, applicable to all insured depository institutions beginning January 1, 2023. The deposit insurance assessment rate schedule increase is consistent with the Amended Restoration Plan that the FDIC Board adopted in June 2022 to restore the Deposit Insurance Fund (DIF) reserve ratio to the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028. Based on data through June 30, 2022, and assuming different rates of insured deposit growth and average assessment rates in two scenarios that the FDIC views as reasonable, the FDIC projects that the reserve ratio will likely reach 1.35 percent in 2024.

The FDIC assesses market movements on an ongoing basis and monitors deposit trends, potential losses, and other factors that affect the reserve ratio based on data reported on a quarterly basis in banks' Consolidated Reports of Condition and Income. For example, the FDIC monitors insured deposit growth, which is difficult to predict because it is affected by many different factors including personal savings rates, consumer spending, and interest rates, among other factors. The FDIC also closely monitors the performance of the banking industry, as losses from past and future bank failures affect the reserve ratio by lowering the fund balance.

The FDIC recognizes and incorporates into its analysis an assessment of market movements, including changes in interest rates and economic growth, which present challenges and could have longer-term effects on the condition and performance of the banking industry. In projecting the DIF reserve ratio, the FDIC handles the complexity of market movements and other factors that affect the DIF by employing scenario analysis with differing assumptions and a range of possible outcomes rather than relying on a single projection.

As of September 30, 2022, the reserve ratio measured 1.26 percent, unchanged from the prior quarter. The FDIC will continue to monitor deposit trends, potential losses, and other factors that affect the reserve ratio. The FDIC Board of Directors is provided an updated analysis and projections at least semiannually. The next update is expected in the first quarter of 2023, reflecting data as of December 31, 2022.

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2. When do you believe the NPR (regarding bank lending in areas where a bank doesn't have a physical presence) will be finalized and become regulatory?

Response

Revising the CRA is one of the top priorities at the FDIC. The NPR represents a major revision of CRA intended to strengthen its impact and increase its transparency and predictability. The three banking agencies received almost one thousand unique comments from a wide range of stakeholders, many of which are quite detailed and thoughtful. The staffs of the three agencies are working diligently to review those comments and consider possible changes to the NPR in response to those comments in developing a final rule. Our hope is to issue a final rule in the early part of 2023.

3. Do you believe that climate change related risks are similar to severe weather events? How do events such as hurricanes and their frequency impact the way the FDIC evaluates risks?

Response

The financial system has always had severe weather events to contend with and, thus far, the banking industry has handled these events well. However, government assistance, insurance proceeds, and other aid were instrumental in reducing the financial consequences of the severe weather events on banks.[35] Agricultural banks know well the effects that drought conditions can have on farming communities; banks in the west understand the impacts of wildfires; and coastal banks have long responded to the annual threat of tropical storms and hurricanes. However, changing climate conditions are bringing with them challenging trends and events that can exacerbate the frequency and intensity of severe weather events. These trends challenge the future resiliency of the financial system and, in some circumstances, may pose safety and soundness risks to individual banks. It is the goal of our work on climate-related financial risk to ensure that the financial system continues to remain resilient despite these growing risks.

4. What best practices has the FDIC adopted since joining the Network of Central Banks and Supervisors for Greening the Financial System?

[35] J. Anderlik; A. Bush; R. Cofer, Jr.; K. Kalser; and J. McGee, "Severe Weather Events and Local Economic and Banking Conditions," (2022), https://www.fdic.gov/analysis/cfr/staff-studies/2022/2022-03.pdf.

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Response

Since joining the Network of Central Banks and Supervisors for Greening the Financial System, the FDIC has established an internal, cross-disciplinary working group to assess the safety and soundness and financial stability considerations associated with climate-related financial risk and to develop an agency-wide understanding of climate-related financial risk in all its forms.

In March, the FDIC issued a request for comments on draft principles that would provide a high-level framework for the safe and sound management of exposures to climate-related financial risks.[36] The draft principles are intended for large financial institutions with over $100 billion in total consolidated assets. The FDIC's proposed principles are substantively similar to the principles that were issued by the Office of the Comptroller of the Currency in December of last year and by the Federal Reserve Board earlier this month. The FDIC's comment period closed in June and comments are currently under review and consideration.

The proposed principles take a risk-based approach, and are intended to support efforts by large financial institutions to focus on the key aspects of climate-related financial risk management. The proposed principles includes general, high-level principles for incorporating climate-related financial risk into an institution's governance and risk management practices and addresses how climate-related financial risks could impact a financial institution's assessment of traditional risk areas, such as credit and other financial and nonfinancial risks, with respect to climate-related financial risk.

[36] See, 87 Fed. Reg. 19507 (April 4, 2022).

Answers to Questions for the Record Following a Hearing entitled "Oversight of Financial Regulators: A Strong Banking and Credit Union System for Main Street" conducted by the Senate Committee on Banking, Housing, and Urban Affairs

On November 15, 2022, the Senate Committee on Banking, Housing, and Urban Affairs convened a hearing at which Michael J. Hsu, Acting Comptroller of the Currency, testified on "Oversight of Financial Regulators: A Strong Banking and Credit Union System for Main Street." After the hearing, members of the Committee submitted questions for the record. This document provides the Office of the Comptroller of the Currency's responses.

The Comptroller of the Currency, from Chairman Sherrod Brown:

1. In your testimony, you highlighted a number of risks on the horizon for the banking system. In order to be prepared for all these risks, banks need strong capital so that they can continue to lend and serve their customers in a downturn. While the largest institutions in the industry claim that stronger capital requirements reduce lending, we saw in 2020 that even while banks were receiving government support, they used their supposedly scarce capital to pay dividends and buyback their stock.

   Question: Why do strong capital requirements protect the banking and credit union system and how do they ultimately better protect working Americans? What are your agencies doing to achieve this goal?

   Response: The regulatory capital framework is designed to ensure that a bank's capital is of a sufficient quality and quantity to support the bank's operations and risk profile, and to protect against insolvency across a range of conditions. Strong capital requirements allow banks to have the capacity to support the flow of credit to the economy by continuing to lend to creditworthy households and businesses through a variety of economic cycles. Strong capital requirements can also help to reduce the frequency or severity of financial crises.

   Banks continue to have strong reported capital levels. The average total risk-based capital ratio for all FDIC insured institutions as of the third quarter of 2022 is 14.84 percent, which is well above the 8 percent minimum. Large banks are projected to remain above their holding company minimum capital requirements, as shown in the Federal Reserve Board's latest annual stress test results.

   Additionally, the OCC continues to monitor banking conditions consistent with safety and soundness principles to support banking organizations' efforts to continue to meet the credit needs of their communities.

2. Most agree that a well-designed regulatory capital framework includes risk-based requirements and a leverage ratio "back-up." The supplementary leverage ratio (SLR) is that back-up. It protects against emerging risks not yet included in the risk-based framework, and against the potential for unexpected losses to be underestimated.

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a. Question: Do you agree that the risk insensitive SLR is necessary, and most effective when it includes all of the bank's assets?

   Response: Following the financial crisis, banking regulators have strengthened the capital regulations and implemented the SLR to put a constraint on the overall leverage in the banking system. The SLR serves as an important backstop to the risk-based capital requirements. Under the SLR, banking organizations include all on-balance sheet assets and certain off-balance sheet assets, e.g., derivatives, in the total leverage exposure.

b. Question: Some fear that including Treasury securities, held on bank balance sheets, in the SLR may lead to problems in Treasury markets. Given the Federal Reserve's standing repurchase agreement facilities and the Inter-Agency Working Group on Treasury Market Surveillance's progress at making the U.S. Treasury market more resilient, is this still a concern? Please explain.

   Response: As indicated in the Treasury Department's Staff Progress Report on Recent Disruptions and Potential Reforms in the Treasury Market dated November 2021, many factors contributed to the Treasury market disruptions at the onset of the pandemic. Any review of the SLR should be done holistically and in conjunction with other components of the capital framework, including risk-based capital and capital buffers.

   Strong capital and liquidity positions permit banks to support the flow of credit to the economy and thus contribute to financial stability and sustained economic growth.

3. Industry consolidation and concentration can hurt local communities and their economies. President Biden has called for a plan to strengthen bank merger guidelines in his Executive Order on Competition. The Fed and the OCC recently approved a megamerger resulting in the 7th largest bank in the United States and are currently reviewing another one, but at the same time, the Fed, FDIC, and OCC have raised concerns about domestic systemically important banks.

   Question: What is your plan to strengthen the bank merger guidelines and look at these mega mergers more closely to ensure they work for Main Street?

   Response: In consultation with the other federal banking agencies and U.S. Department of Justice (DOJ), the OCC is assessing whether and how to update the frameworks for analyzing bank mergers. The banking industry has changed significantly in the last several decades. Our goal in this endeavor is to ensure that the analyses underlying the frameworks for bank merger decisions: (i) are updated to reflect the current state of the banking industry; and (ii) align with statutory criteria to permit only those mergers that promote competition, do not threaten financial stability, and facilitate the convenience and needs of all the communities served by the banks.

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The OCC has announced that it will host a symposium on bank mergers on February 10, 2023. The symposium will promote public input and discussion regarding the frameworks for analyzing bank mergers under federal law, including topics such as competition, financial stability, and convenience and needs. The symposium complements interagency efforts and builds on public momentum to engage in discussions on how best to improve bank merger outcomes to benefit communities, enhance competition, and support a diverse banking system.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Ranking Member Toomey:

Crypto

1. During the hearing on November 15, 2022, Federal Reserve Board (FRB) Vice Chair for Supervision Barr stated that it would be "useful for [the banking agencies] to provide guidance to the banking sector about how to safely custody crypto assets." In July 2020, however, the Office of the Comptroller of the Currency (OCC) issued guidance stating that national banks may provide custody services for crypto assets.[1]

    a. Question: Do you agree that it would be useful for the OCC to provide further guidance to the banks it regulates about how to safely custody crypto assets?

    b. Question: Do you agree with the OCC's analysis? If not, please explain whether you believe national banks may provide custody services for crypto assets and whether you believe that providing custody services for crypto assets differs from any other assets for which banks provide safekeeping and custody services.

    Response: The OCC issued Interpretive Letter 1170 in July 2020 to address crypto-asset custody at national banks. In November 2021, the OCC supplemented this letter with Interpretive Letter 1179. This supplemental letter emphasized the importance of safety and soundness in connection with crypto-asset custody activities. Interpretive Letter 1179 provides that a bank's crypto-asset custody activities are legally permissible for a bank, provided the bank can demonstrate, to the satisfaction of its supervisory office, that it has controls in place to conduct the activity in a safe and sound manner. This letter also sets forth the supervisory non-objection process that an OCC-regulated bank must follow to demonstrate that it is capable of conducting such activities in a safe and sound manner. Recent events demonstrate the importance of ensuring that banks that seek to engage in crypto-asset custody activities have the capacity to do so in a safe and sound manner. On January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[2]

2. Earlier this year, the Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin 121 (SAB 121), which provides that crypto assets held in custody should be treated as on-balance sheet assets.[3] It has been reported that the SEC staff "did not consult with the banking regulators" before issuing SAB 121.[4] This staff guidance is posing

[1] https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2020/int1170.pdf.
[2] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.
[3] https://www.sec.gov/oca/staff-accounting-bulletin-121.
[4] https://www.reuters.com/technology/us-secs-crypto-guidelines-push-up-costs-lenders-disrupting-projects-2022-09-16/.

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significant challenges for crypto custody by banks, which are subject to capital and liquidity requirements based on their balance sheet assets.

a. Question: Do you believe that the SEC staff guidance is appropriate? Please explain.

   Response: The SEC plays an important role in developing financial reporting standards applicable to publicly listed companies in the United States. Most publicly listed companies that issue securities to the public – are not regulated banks and are not subject to prudential supervision. By law (12 U.S.C. 1831n), all national banks and federal savings associations must follow reporting standards that are no less stringent than U.S. Generally Accepted Accounting Principles (GAAP). We understand that these institutions, in consultation with their auditors, are analyzing the intersection of SAB 121 and GAAP. The OCC is monitoring these discussions.

b. Question: Are you aware of any other assets held in custody that are treated as on-balance sheet assets under U.S. generally accepted accounting principles (GAAP)?

   Response: The OCC is not aware of any other assets held in custody that are treated as on-balance sheet assets under U.S. GAAP.

c. Question: Have the banking agencies ever allowed regulated banks to depart from GAAP for purposes of bank regulations? If so, please describe those circumstances.

   Response: In establishing capital requirements for national banks and federal savings associations, the OCC generally follows U.S. GAAP as a starting point. Section 37(a) of the Federal Deposit Insurance Act (12 U.S.C. 1831n(a)) requires that the federal banking agencies prescribe accounting principles for regulatory reporting purposes that are no less stringent than U.S. GAAP. When permitted by statute, the OCC has at times adjusted U.S. GAAP balance sheet amounts for certain regulations. For example, certain banks may neutralize the effect of accumulated other comprehensive income (AOCI) when calculating regulatory capital.

   In addition, for certain significant accounting changes and market disruptions (e.g., COVID-19), the federal banking agencies have provided temporary regulatory capital relief by adjusting U.S. GAAP balance sheet amounts through rulemaking. For example:

   In February 2019, the agencies issued a final rule to address changes to credit loss accounting under U.S. GAAP related to the current expected credit losses methodology (CECL). The rule provided banking organizations the option to phase in over a three-year period the day-one adverse effects on regulatory capital that may result from the adoption of the new CECL accounting standard.

   In March 2020, in response to the COVID-19 pandemic, the agencies issued an interim final rule that provided banking organizations that were required under U.S.

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GAAP to implement CECL before the end of 2020 the option to delay for two years an estimate of CECL's effect on regulatory capital, relative to the incurred loss methodology's effect on regulatory capital, followed by a three-year transition period.

In May 2020, the agencies issued an interim final rule to provide depository institutions subject to the supplementary leverage ratio the ability to temporarily exclude Treasuries and deposits at Federal Reserve Banks from the total leverage exposure calculation through March 31, 2021.

3. On November 23, 2021, the Fed, the Federal Deposit Insurance Corporation (FDIC), and the OCC issued a statement describing their crypto-asset policy sprint initiative and next steps.[5] The statement noted that, throughout 2022, the agencies plan to provide "greater clarity on whether certain activities related to crypto-assets conducted by banking organizations are legally permissible," including the issuance and distribution of stablecoins. Although the Fed, FDIC, and OCC have not provided further guidance on bank-issued stablecoins, a recent paper asserts that issuing stablecoins "clearly fall[s] within the existing legal authority of banks to conduct the business of banking."[6]

    a. Question: In your view, is it legally permissible for OCC-regulated banks to issue stablecoins?
    b. Question: If not, how do you distinguish stablecoin issuance from this activity?

Response: OCC Interpretive Letters 1174 and 1179 address the authority of OCC-regulated banks to issue stablecoins to facilitate payment activities. Under those letters, issuing a stablecoin to facilitate payments is permissible for an OCC-regulated bank, provided that the bank conducts the activity in compliance with applicable laws and the bank can demonstrate, to the satisfaction of its supervisory office, that it has controls in place to conduct the activity in a safe and sound manner. Interpretive Letter 1179 details the supervisory non-objection process that OCC-regulated banks must follow to demonstrate that they have systems and controls in place to engage in the activity in a safe and sound manner. OCC-regulated banks must request and receive a supervisory non-objection prior to issuing any stablecoin. Recent events demonstrate the importance of ensuring that banks that seek to engage in crypto-asset activities, including payment stablecoin activities, can do so in a safe and sound manner. On January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[7]

[5] https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.
[6] https://www.theclearinghouse.org/payment-systems/Articles/2022/11/11082022_Stablecoin-related_Activities.
[7] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.

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4. In November 2021, the OCC issued an interpretive letter stating that certain crypto custody, distributed ledger, and stablecoin activities are permissible "provided the bank can demonstrate, to the satisfaction of its supervisory office, that it has controls in place to conduct the activity in a safe and sound manner."[8]

   a. Question: Please provide a list of banks that the OCC believes have demonstrated sufficient controls to conduct crypto custody and distributed ledger activities since issuing this guidance last year.

   b. Question: Please provide a list of banks that the OCC believes have demonstrated sufficient controls to conduct stablecoin activities since issuing this guidance last year.

   Response: Crypto-asset activities among banks have been limited and primarily centered on custody or providing banking services to businesses engaged in cryptocurrency activities. The OCC has received very few formal requests for supervisory non-objection pursuant to Interpretive Letter 1179. The bank-specific information you requested includes confidential supervisory information and non-public commercial information. The OCC maintains the confidentiality of this information to promote the supervisory process. On January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[9]

Credit Underwriting

5. On November 16, 2022, the U.S. Department of the Treasury released a report entitled *Assessing the Impact of New Entrant Non-bank Firms on Competition in Consumer Finance Markets*.[10] Among other things, the report recommends that federal banking regulators "engage with supervised institutions that are seeking to prudently implement new credit underwriting approaches—including those using alternative data analytics to inform credit decisions" in order to increase competition in consumer credit underwriting. Often, insured depository institutions (IDIs), particularly small and mid-sized IDIs, turn to fintech partnerships to develop and implement innovative consumer underwriting approaches.

   a. Question: How have you helped small IDIs build responsible partnerships that offer wider access to credit through underwriting innovation?

   Response: The OCC established the Office of Innovation in January 2017 to implement a framework to support responsible innovation that enhances the safety and soundness of the federal banking system, treats customers fairly, and promotes

[8] https://occ.gov/topics/charters-and-licensing/interpretations-and-actions/2021/int1179.pdf.
[9] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.
[10] https://home.treasury.gov/system/files/136/Assessing-the-Impact-of-New-Entrant-Nonbank-Firms.pdf.

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financial inclusion. Through various outreach activities, including Office Hours events, the Office of Innovation engages with OCC-supervised banks, including community banks, to provide technical assistance when looking to innovate.

The OCC also jointly issued guidance for OCC supervised banks and other banks, including community banks, that may assist banks interested in engaging with a fintech company to develop and implement innovative consumer underwriting approaches. For example, in December 2019, the OCC, FDIC, Federal Reserve Board, Consumer Financial Protection Bureau, and National Credit Union Administration issued an interagency statement on the use of alternative data in underwriting by banks, credit unions, and nonbank financial firms. The statement focuses on the consumer protection implications of the use of alternative data in credit underwriting, highlighting the potential benefits and risks. Also, in August 2021 and as reflected in OCC Bulletin 2021-40, the OCC issued "Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks," along with the Federal Reserve Board and FDIC. This guide supports responsible innovation within the federal banking system by providing community banks with information that may be relevant when conducting due diligence on financial technology companies.

Additionally, in July 2020, the OCC launched the Roundtable for Economic Access and Change (Project REACh), using its convening authority. Project REACh participants work to identify and reduce structural barriers to full, equal, and fair participation in the nation's banking system and the economy. One of the Project REACh workstreams—the Alternative Credit Assessment Workstream—is evaluating the use of alternative data sources to boost the measurable creditworthiness of the almost 50 million Americans, disproportionately including poor and minority Americans, who lack a credit score and cannot obtain credit; yet many meet their recurring financial obligations.

b. Question: In light of the Treasury report, what additional steps will you take to expand responsible fintech partnerships that innovating in the underwriting space?

   Response: The OCC continues to support the use of new or improved financial products, services, and processes to meet the evolving needs of consumers, businesses, and communities in a manner that is consistent with sound risk management and is aligned with a bank's overall business strategy. The OCC's formation of the Office of Financial Technology in 2023 will build on and incorporate the Office of Innovation and will bolster the agency's expertise and ability to adapt to a rapidly changing banking landscape.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Senator Jon Tester:

Community Reinvestment Act:

1. During the hearing, we discussed your agencies' proposed changes to the Community Reinvestment Act, and how they would incorporate the unique needs of rural communities and Indian Country into their proposal.

   Question: How will you evaluate success of those changes? One of the greatest challenges I hear about in communities across Montana, and most places across the country, is the availability of housing people can afford – there just isn't enough.

   Response: Consistent with current rules, the proposal establishes performance tests– based on a bank's size and business model – to be used in a bank's CRA examination to determine whether the bank is meeting its obligation to provide credit to the communities where it is chartered to do business. These tests include evaluating the level of lending to low- and moderate-income borrowers and the level and responsiveness of community development activities, as applicable based on the bank's type and size.

Housing:

2. Question: How would these CRA changes effect housing supply?

   Response: The CRA encourages banks to help meet the credit needs of the communities where they are chartered. To the extent the availability of credit may influence or effect the housing supply, the clarifying performance tests and community development definitions proposed in the NPR for evaluating bank CRA performance are intended to help increase bank investments, lending, and services that benefit low- and moderate-income persons and communities and other targeted areas, including distressed and underserved nonmetropolitan middle-income census tracts and Native Land Areas.

Cybersecurity:

3. Cybersecurity isn't a new challenge, but it's certainly a growing problem. There are more robust requirements for financial institutions around data security than many industries, but we've still seen problems in recent years.

   It's clear that we need to be doing more to address these threats, whether through coordination, actions from you all and other regulators and agencies, the private sector, or additional work from us here in Congress. Much of that intersects with your work.

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Question: How can you as regulators better help the institutions you regulate protect themselves from cybersecurity threats? Especially smaller community financial institutions What more should we be doing to address threats to cybersecurity?

Response: The OCC recognizes cybersecurity threats as a key risk to the financial sector, and we have highlighted this in our Fall 2022 Semiannual Risk Perspective. We continue to actively collaborate with fellow banking regulators, other federal agencies, and private sector stakeholders—through forums such as the Financial and Banking Information Infrastructure Committee (FBIIC)—to support and strengthen the cybersecurity preparedness of the financial sector. The OCC is committed to working with the Cybersecurity and Infrastructure Security Agency (CISA), our financial sector counterparts, and other sectors to ensure that we have strong partnerships across the government.

Through supervisory guidance, including the October 2022 FFIEC update to its Cybersecurity Resource Guide for Financial Institutions, the OCC continues to highlight the importance of maintaining increased cybersecurity vigilance, implementing effective controls to safeguard against cyber attacks, and maintaining adequate operational resilience to recover and continue critical operations in the event of a significant cyber disruption. Banks should tailor their cybersecurity strategies for the size and complexity of their operations, their risk appetite, and the role they play in the sector's critical infrastructure. These strategies should include critical third-party service providers that support many banks' operations.

As cybersecurity threats continue to emerge and evolve, the OCC along with the FDIC and Federal Reserve Board implemented a computer-security incident notification rule. Notification of this critically important information allows the banking agencies to assess more rapidly the impact and risk of cybersecurity incidents to the individual institution and to the broader sector, and also allows more timely supervisory response and assistance to the impacted firm.

While there are many efforts the OCC takes to support banks' cybersecurity preparedness, the most impactful is our regularly scheduled examinations and ongoing communication with the individual banks we supervise. Additional information on the OCC's assessment of the cybersecurity preparedness of the federal banking systems and our supervisory efforts is available in the OCC's annual Cybersecurity and Financial System Resilience Report to Congress.

FHFA Capital Rules:

4. The Federal Reserve's recent efforts to rein in inflation through interest rate hikes have resulted in unrealized losses which have affected community banks' tangible book values but not their regulatory capital levels. The Federal Housing Finance Agency's policy on tangible capital—which is inconsistent with the federal banking regulators— limit access to Federal Home Loan Bank advances to banks that have negative tangible book values even though they are considered "well capitalized" by the regulatory agencies.

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Question: What steps are the regulators taking to ensure that reasonable investments that community banks made in US Treasuries that have resulted in unrealized losses do not become a supervisory crisis?

Response: The OCC is closely monitoring the impact that rising interest rates are having on banks' investment portfolios including the effect of unrealized non-credit losses on GAAP equity. The OCC has conducted outreach with examination staff and provided supervisory considerations for examiners when reviewing a bank's investment portfolio and the effects of rising rates on liquidity, interest rate risk, earnings, and capital. Any supervisory concerns should be assessed using a holistic approach that encompasses interconnected risks and associated risk management. It is important for banks to have effective asset and liability risk management practices to navigate interest rate changes. Additionally, it is important for banks to have sound liquidity management that includes ensuring access to efficient and diversified sources of liquidity and contingency funding plans that identify alternative funds to meet liquidity needs.

Under 12 CFR 1, national banks are generally permitted to purchase US Treasury securities without limit. If an institution holds the investment until maturity, there are no liquidity concerns. In relation to regulatory capital, the OCC continues to believe that the regulatory capital framework provides a sound foundation for evaluating capital adequacy. However, we also note that regulatory capital standards represent a starting point for assessing capital adequacy. The OCC expects banks to have a rigorous process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive strategy for maintaining an appropriate level of capital. Banks may also use scenario analysis and stress testing to assist with this capital adequacy assessment. Banks typically operate with capital positions above regulatory minimum requirements to align capital with their risk profiles.

The OCC actively participates in an interagency working group of federal banking agencies to monitor and share information on the impacts of rising interest rates on banks. The interagency working group facilitates coordination and consistency in supervisory efforts.

Question: Are regulators taking steps to work with banks that are impacted? Is there a regulatory process in place so that a bank can seek a waiver from the FHFA's tangible capital rule?

Response: As part of the OCC's ongoing supervision, examiners are communicating with banks that may have negative tangible capital to assess the banks' current financial condition, liquidity positions, and future funding needs. The OCC is also assessing the banks identified as vulnerable to reporting negative tangible capital in future periods if interest rates continue rising. Agency-wide training conducted this past September provided examiners with an array of considerations for assessing banks' risk profile related to liquidity, interest rate risk, capital, and earnings.

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The OCC has established a process to review requests from banks regarding FHLB advances. Any request from banks will be reviewed and considered through a coordinated internal process to ensure an appropriate and consistent agency response to all such requests. The OCC would assess a request from a bank based on the facts and circumstances of the particular bank, which may include considering the availability of other sources of liquidity.

Question: Have the regulators engaged with FHFA to prevent this from becoming a liquidity issue that further puts pressure on the already fragile housing market?

Response: Yes, the OCC and the other Federal banking agencies are engaging with the FHFA on this issue. At the same time, we recognize the rulemaking and examining authority over FHLB activities falls within the FHFA's purview. As such, we defer to the FHFA on how best to supervise their regulated entities.

S.2155:

5. I think that the pandemic really showed that our bipartisan *Economic Growth, Regulatory Relief, and Consumer Protection Act* struck the right balance.

   During the pandemic we saw financial institutions able to step up and serve their communities, with the balance sheets and protections to withstand the economic crisis that came with it.

   In Montana, our community banks and credit unions stood up to make programs like PPP work for small businesses on their Main Streets and keep folks employed.

   Question: Do you think the banking and credit union sectors you oversee are safe and secure right now?

   Response: Yes, currently national banks and federal savings associations are well capitalized with ample liquidity and sound credit quality. The quantity of credit risk in commercial and retail loan portfolios in aggregate is moderate, attributed to growth, utilization trends, and economic uncertainty. Loan portfolio performance in aggregate has been resilient but signs of potential weakening in some segments warrant careful monitoring.

   Question: Where are there areas that give you concern?

   Response: Despite favorable performance of consumer portfolios, economic and geopolitical headwinds are a challenge for retail credit portfolios. The continued inflationary environment has kept pressure on consumer balance sheets as the price of rent, gasoline, groceries and other non-discretionary items outpaces wage growth. This risk is more pronounced for vulnerable segments at the lower end of the income spectrum. Higher interest rates have increased borrowing costs on products such as credit cards, automobiles and home purchases, further adding to consumer balance sheet pressure. Mortgage rates in particular have

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significantly cooled the housing market. This may lead to home price depreciation which will affect some homeowner's ability to sell or refinance their homes. Supply chain issues impacting automobiles increased prices significantly and is also impacting affordability.

As values stabilize or decline, automobile loan balances may exceed the value of the collateral and could impact loss severity. Payment hierarchy changes may differ from prior downturns, impacted by borrowers that had COVID loan forbearance as well as economic factors detailed above.

The impacts of inflation and interest rates have not manifested in higher credit losses to date. However, consumers with low- and moderate income and overall higher debt balances could contribute to higher losses if a precipitating event such as high unemployment occurs.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Senator Raphael Warnock:

1. The recent news about FTX underscores the necessity of robust regulation in our financial markets, especially for novel financial instruments like digital assets and cryptocurrencies that have largely operated freely and with impunity. I understand that this industry touches all four of your agencies differently, and jurisdictional lines are still being drawn. Ultimately it is up to Congress to create a stable regulatory environment for the digital asset industry and to define those lines.

   Question: However, in the meantime, what are your agencies doing to safeguard everyday Americans and the financial system against a crypto-connected crisis, as we saw with FTX?

   Response: Last year, the OCC adopted a "careful and cautious" approach to crypto activities by national banks and federal savings associations. This helped mitigate the risk of contagion from recent crypto market stress to the national banking system and, in turn, to customers of national banks and federal savings associations.

   Under OCC Interpretive Letter 1179, crypto activities that have been the subject of prior OCC letters are only legally permissible for a bank to engage in provided the bank can demonstrate, to the satisfaction of its supervisory office, that it has systems and controls in place to conduct the activity in a safe and sound manner. Interpretive Letter 1179 also requires that institutions obtain written supervisory non-objection prior to commencing any crypto-asset activity.

   This year, we will establish an Office of Financial Technology, which will build upon the work of the OCC's Office of Innovation and help ensure that the national banking system remains trusted and safe, sound, and fair as the crypto ecosystem evolves.

   On January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[16]

   We will continue to collaborate and coordinate with other banking and market regulatory agencies to pursue common understanding of the risks and opportunities presented by crypto-assets and to ensure that regulatory standards remain high and that the playing field stays level. The impact of crypto-assets and related products on national bank and federal savings association customers are top of mind in these considerations and efforts.

2. Question: What have you been doing to educate firms and consumers under your jurisdiction about the risks associated with these entities, especially those operating offshore?

[16] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.

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Response: The OCC is a member of the Financial Literacy and Education Commission (FLEC), which is coordinated by the Department of the Treasury. The FLEC acts to support its vision of sustained financial wellbeing for all individuals and families in the United States. One of FLEC's current objectives is to offer consumers and financial educators free and trustworthy information about crypto-assets on the mymoney.gov website. The OCC supports the FLEC's objective of providing important unbiased information to consumers regarding crypto-assets so that they can make informed decisions. The OCC is collaborating with the FLEC to coordinate and promote consumer awareness about how to avoid frauds and scams, and ensure consumers know where to go if they do encounter one. This work builds upon the recommendations in the Treasury report *Crypto-Assets: Implications for Consumers, Investors, and Businesses*. In addition, on January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[17]

The OCC appreciates the importance of public awareness of the risks of crypto-assets, themselves as well as associated products, services, and activities, particularly in communities that may not have been historically well served by the traditional banking system. To this end, OCC staff joined the FLEC digital assets working group in March 2022 to develop consumer materials clearly explaining crypto-asset concepts, including how crypto-assets differ from traditional financial instruments. Additionally, in April, the OCC hosted a discussion focused on the tension within communities of color regarding the risks and opportunities in crypto and other digital assets. Further, in May 2022, the OCC co-hosted a summit in Atlanta on crypto and other digital assets with the financial education group Operation Hope, gathering diverse viewpoints from a range of panelists on topics such as the durability and risks of digital assets and the role of regulation to enable responsible innovation and protect consumers.

3. Question: Banking deserts drive everyday Americans to use predatory lending services and other firms that take advantage of the lack of options available in communities. What steps are you taking to ensure that folks that live in banking deserts have access to basic banking services?

   Response: Part of the OCC's mission is to ensure that its supervised banks provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations, including fair lending laws such as the Fair Housing Act and, for banks with $10 billion or less in assets, the Equal Credit Opportunity Act (ECOA). This work supports the OCC's priority of reducing inequality in the federal banking system.

   To carry out this mission, the OCC's comprehensive process for supporting fair treatment of customers includes conducting fair lending risk assessments every supervisory cycle for each

[17] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.

bank that engages in retail lending and conducting reviews of Home Mortgage Disclosure Act (HMDA) data to support a risk-based fair lending examination strategy.

Through Project REACh, the OCC convenes leaders from the banking industry, national civil rights organizations, business, and technology to reduce specific barriers that prevent full, equal, and fair participation in the nation's economy. Workstreams addressing affordable homeownership and small and minority businesses seek to increase financing opportunities for low- and moderate-income and minority home-buyers and small businesses, respectively, through collaborative approaches that seek to overcome the lack of traditional credit availability.

4. Question: What are your agencies doing to promote responsible small-dollar lending by the financial institutions you regulate? Please describe how your agencies are measuring the effectiveness of your efforts to date and share supporting data if available.

   Response: The OCC has engaged in interagency and other efforts to support responsible small-dollar lending. For example, on May 20, 2020, and as reflected in OCC Bulletin 2020-54, the OCC transmitted the "Interagency Lending Principles for Offering Responsible Small-Dollar Loans," along with the Federal Reserve Board, FDIC, and NCUA. As reflected in these principles, the agencies recognize the important role that offering small-dollar loans in a responsible manner can play in helping customers meet their ongoing credit needs due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national emergencies, or disaster recoveries. Through the principles, the agencies encourage financial institutions to offer responsible small-dollar loans to consumers and small businesses.

   On March 26, 2020, and as reflected in OCC Bulletin 2020-25, the OCC, along with the Federal Reserve Board, CFPB, FDIC, and NCUA, issued the "Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19," which states that federally supervised financial institutions are well-suited to meet the credit needs of customers affected by the COVID-19 emergency and specifically encouraged financial institutions to offer responsible small-dollar loans to both consumers and small businesses.

   The OCC also established the Office of Innovation in January 2017 to implement an agency framework to support innovation in the federal banking system in a manner that is consistent with sound risk management, encourages fair access to financial services, and promotes financial inclusion.

   The OCC encourages examiners to review and discuss with bank management new small-dollar loan and other product offerings, asset growth, credit performance (i.e., delinquency and loss levels), risk and account management practices and credit quality at their assigned institutions on at least a quarterly basis. The OCC, in conjunction with the other bank regulatory agencies, has held outreach events for bankers highlighting agency policy

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regarding small dollar lending and identifying examples of effective approaches financial institutions have taken in offering such products.

5. In July 2020, the OCC allowed federally chartered banks to offer custodial services for cryptocurrencies.

   Question: What discussions did the OCC have about risks, constraints within these services, disclosures or any other protections before making this decision?

   Response: Interpretive Letter 1170 concluded that banks may provide certain crypto-asset custody services on behalf of customers. The letter stated that banks that conduct crypto-asset custody services must do so in a safe and sound manner, including having adequate systems in place to identify, measure, monitor, and control the risks of its custody services. The letter stated that these risk-management systems should include policies, procedures, internal controls, and management information systems governing custody services. The letter also outlined specific internal controls and risk management considerations for crypto-asset custody, while noting that standard internal controls may need to be tailored in the context of crypto-asset custody. The letter further stated that banks that conduct crypto-asset custody services must comply with applicable laws and emphasized that banks engaging in new activities, such as crypto-asset activities, should develop and implement those activities consistent with sound risk management practices and align them with the bank's overall business plans and strategies as set forth in OCC guidance.

   The OCC subsequently issued Interpretive Letter 1179, which further emphasized the importance of safety and soundness for banks that seek to conduct crypto-asset custody activities. Specifically, Interpretive Letter 1179 states that the activities addressed in Interpretive Letter 1170 (and two other interpretive letters) are legally permissible for a bank to engage in, provided the bank can demonstrate, to the satisfaction of its supervisory office, that it has controls in place to conduct the activity in a safe and sound manner. Interpretive Letter 1179 details the supervisory non-objection process that OCC-regulated banks should engage in to demonstrate that they are capable of conducting crypto-asset custody in a safe and sound manner. OCC-regulated banks should request and receive a supervisory non-objection prior to engaging in crypto-asset custody.

   Recent events demonstrate the importance of ensuring that banks that conduct crypto-asset activities, including custody, do so in a safe and sound manner. We recognize that crypto-assets present technological complexity, which requires sufficient expertise for a firm to provide crypto-asset custody services in a safe and sound manner. The OCC will continue to carefully and cautiously evaluate each requesting bank's ability to provide crypto-asset custody services in a safe and sound manner. In addition, we note that on January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking

organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[18]

[18] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Senator Mike Rounds:

1. Following an influx of deposits generated by government stimulus, the FDIC approved an aggressive proposal to uniformly increase bank deposit insurance assessment rates by 2 basis points until the Deposit Insurance Fund reaches a designated reserve ratio of 2%. Meanwhile, the OCC approved a 40% reduction in assessments for OCC-chartered community banks.

   a. Question: Did the FDIC consult with you or any staff at the OCC before making the decision to increase assessment rates affecting only state-charted community banks?

      Response: In October 2022, the FDIC Board, of which I am a member, approved a final rule to increase the initial base deposit insurance assessment rate schedules for all insured depository institutions by 2 basis points. This increase applied to both state-chartered banks and federally-chartered banks.

      The increase in assessment rate schedules helps the FDIC meet its statutory obligation to ensure that the Deposit Insurance Fund (DIF) reserve ratio will reach the statutory minimum of 1.35 percent by the statutory deadline of September 30, 2028. Two years prior, when the FDIC initially adopted the DIF Restoration Plan, the DIF reserve ratio was projected to increase and return to the statutory minimum without the need to increase the assessment rate schedules. Since that time, however, the reserve ratio had fallen. Simply put, there was lost ground that needed to be made up.

      While insured deposit growth had shown signs of normalizing, aggregate balances remained significantly elevated. The modest rate increase, while the banking industry was strong and profitable, reflected prudent risk management and reduced the risk that the FDIC will need to take more dramatic and disruptive action in the future when banking and economic conditions may be less favorable.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Senator Jerry Moran:

1. In its current form, the Agencies' proposed rule requires banks utilizing Strategic Plans to be assigned new Assessment Areas based upon where specific lending activities already occur, concentrating competition among many lending institutions, including nonbanks, for the same loans and creating the unintended consequence that focused efforts on arbitrarily chosen lending activities, instead of allowing for innovation and creativity in meeting the most critical financial needs of a community. Ultimately, providing loans or community development investments and services only to the most heavily populated areas will divert financial and human capital from less densely populated areas. This outcome is completely contradictory to the goals of serving bank deserts - one of the goals the Agencies claim is a primary focus of CRA modernization.

   Question: Are the Agencies willing to fix the discrepancies identified above, and preserve the Strategic Plan Option in its current form as part of the final rule, to ensure the current goals and objectives that meet communities' needs and accommodate an individual bank's capabilities due to the superior community benefit the Plan provides and the ability to create innovative investments while promoting regulatory and public engagement? Banks that collaborate under the Strategic Plan with their prudential regulators and community stakeholders to serve those communities as intended under the Act, have achieved great outcomes, and have been recognized by you, their prudential regulators, earning repeated Outstanding CRA ratings.

   Response: The OCC understands the importance of a bank's collaboration with community stakeholders with respect to its strategic plan, and the proposal aims to allow for greater public input. The Agencies received many comments on the proposed CRA rule, including those you reference related to the strategic plan provisions. The Agencies currently are reviewing these comments.

2. The Strategic Plan allows the bank and the regulator to work together if alterations to the plan are required, allowing the bank to optimally serve their communities, especially those that include low- and moderate-income populations, as well as investing in underserved areas like banking deserts, communities the regulators also seek to serve in CRA modernization.

   Question: Why are the Agencies proposing a one-size-fits-all approach for Strategic Plans that will create a purely formulaic approach to fulfill the requirements of the Community Reinvestment Act, which will deprive some banks of the essential flexibility to meet the unique development needs of many underserved communities in which they operate, and for which the Agencies have historically rewarded creative and innovative CRA approaches to serve those same communities?

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Response: The Agencies proposed a number of provisions to provide more clarity about establishing strategic plans, the measurable goals established, and where performance is evaluated. The preamble to the proposal also indicated that the more specific strategic plan criteria would ensure that all banks have a strong justification for why a strategic plan is necessary for their business model and strategy, and that banks evaluated under a strategic plan incorporate how the bank's retail lending and other activities help to meet the credit needs of low- and moderate-income individuals and communities whenever possible. These proposed amendments were intended to address concerns about parity expressed by some stakeholders as well as to make it easier for the public to engage in the development of CRA strategic plans.

3. The Agencies' efforts to address climate change through financial regulation have significantly increased in recent years. Contrary to research from the Federal Reserve Bank of New York, many regulators assert that the effects of climate change pose an existential risk to banks. While not directly mandating climate-related policies for banks, statements and principles issued by the Agencies seem to heavily insinuate that supervised banks need to incorporate certain efforts against climate change or else be subject to unwanted regulatory attention.

    a. Question: Will you provide an example of a U.S. financial institution that failed due to climate change?

       Response: The OCC's mission includes ensuring that the financial institutions it supervises, national banks and federal savings associations, operate in a safe and sound manner. While to date no OCC-supervised financial institution has failed as the result of climate change, both the physical and transition risks associated with climate-related financial risks may have safety and soundness implications for OCC-regulated entities.

    b. Question: Given the absence of standardized data reporting on climate risk, how are you confident that the metrics used to measure a bank's climate risk provide an accurate representation?

       Response:

       The OCC is focused on learning about the efforts of the largest supervised financial institutions, those with over $100 billion in total consolidated assets. OCC examiners will continue to focus on developing an understanding of banks' efforts in integrating climate-related financial risks into their risk management frameworks. Examiners will monitor the development of climate-related financial risk management frameworks at these banks and will engage with bank management to understand the challenges banks face, including those pertaining to data and metrics.

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c. Question: Will you commit to ensuring that financial institutions with climate-related risk exposure will not be subject to regulatory retaliation until a standardized framework is agreed upon by industry and regulators?

   Response: At this time, the OCC's supervision activities with respect to climate-related financial risk are focused on better understanding how those risks may affect banks' safety and soundness.

4. The banking regulators have not finalized the proposed interagency third-party risk management guidance despite the comment period closing over one year ago. However, in a September speech, you highlighted the growth of banking-as-a-service (BaaS) and went so far as to compare the complexity of these arrangements to some of the structured financing vehicles that preceded the 2008 financial crisis. Around the same time, the OCC issued a consent order against a community bank for having insufficient oversight and controls over its fintech partnerships.

   a. Question: When do you plan to finalize the interagency guidance?

      Response: The OCC, FRB, and FDIC based the proposed interagency guidance on the OCC's existing third-party risk management guidance issued through OCC Bulletins 2013-29 and 2020-10. After the issuance of the proposed guidance, in August 2021 and as reflected in OCC Bulletin 2021-40, the agencies issued "Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks."

      The OCC remains firmly committed to issuing interagency guidance. Since the comment period closed on October 18, 2021, the agencies have evaluated the comments received and gained consensus on the key themes raised by commenters. Banks can continue to reference the OCC's existing third party risk management guidance, OCC Bulletin 2013-29 "Third Party Relationships: Risk Management Guidance," which is the basis of the proposed interagency guidance. Additional guidance available also includes OCC Bulletin 2020-10, "Third Party Relationships: Frequently Asked Questions to Supplement OCC Bulletin 2013-29" and OCC Bulletin 2021-41, "Third Party Relationships: Conducting Due Diligence on Financial Technology Companies: A Guide for Community Banks," which was published in August 2021 as an interagency statement by the federal banking agencies to support responsible innovation within the federal banking system.

   b. Question: Do you intend to provide additional guidance to the industry regarding Baas?

      Response: Current OCC third-party risk management guidance and the proposed interagency guidance articulate longstanding principles of third-party risk management that are applicable to all third-party relationships, including those with

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fintech companies. Unique arrangements such as BaaS relationships are within scope of the OCC's definition of third-party relationships under current OCC guidance ("A third-party relationship is any business arrangement between a bank and another entity, by contract or otherwise"). Banks engaging in BaaS should adopt risk management processes commensurate with the level of risk and complexity based on the nature of the arrangement. The OCC will continue to monitor these relationships and issue additional guidance if needed pending further analysis.

5. CRA stakeholders—including some community advocates—have raised concerns that the interagency CRA proposal is overly partisan, which could result in a rulemaking that will not stand the test of time.

   Question: Do you believe the durability of a new regulatory framework is important? What can the agencies do to ensure that a modernized regulation will not fall victim to shifting political winds, a result that would not benefit communities, banks, or regulators?

   Response: Addressing inequality in the federal banking system is one of my top priorities as Acting Comptroller. I believe a modernized CRA framework will be helpful to achieve this goal. The proposed CRA framework seeks to encourage banks to increase lending, investment, and service activities that are responsive to the needs of low- and moderate-income borrowers, small businesses, and small farms in the communities where they lend and take deposits. Reinvestment in communities, and especially in low and moderate-income communities, is the bedrock of the CRA and has remained so in the years since the last major update to the regulation in 1995.

   Career staff, senior leaders, and principals at the OCC, FRB, and FDIC worked closely to develop the proposed rulemaking to update and modernize the CRA rules. This diverse group of policy specialists, lawyers, and economists provided a broad range of diverse viewpoints in developing the proposed rule. In doing so, the agencies engaged in the notice and comment requirements of the Administrative Procedure Act, which provided an opportunity for the public to comment on the proposal. The agencies received over 650 comments in response to the proposed rule. Agency staff continue to review and consider all comments and alternative suggestions offered by commenters representing a wide range of stakeholders, including community organizations and advocates, local and state governments, individuals, banks, and bank and nonbank trade associations. This public input will help to ensure the appropriateness, and therefore the durability, of a final rule.

6. Many comment letters responding to the interagency CRA proposal expressed concern about the complexity of the proposed Retail Lending Test and its associated performance metrics.

   Question: Is this a concern that you share? Do you believe that the test and its performance metrics would understandable and manageable for community banks—including community banks with assets of only $2 billion that will be considered "large banks" under the proposal?

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Response: In the proposed rule, the Agencies added metrics and benchmarks to the CRA performance evaluation in response to stakeholders' concerns that the current rule is too subjective. Incorporating a more quantitative approach to the CRA evaluation would promote objectivity, consistency, and transparency. The Agencies continue to review comments related to multiple aspects of the Retail Lending Test, along with other comments on the proposal. The OCC will take those comments into consideration when making decisions on any final rule.

7. According to the preamble to the proposal, 34% of "large" banks (defined as having assets of $2B or more) would fail the Retail Lending Test in their new Retail Lending Assessment Areas. Numerous times, the proposal states that this is "appropriate" but does not explain the agencies' rationale for proposing performance benchmarks that would represent such a significant shift in CRA ratings.

   Question: Please explain why the agencies believe it is "appropriate" to set the Retail Lending performance measures at a level where 1/3 of banks would receive an Unsatisfactory rating in their Retail Lending Assessment Areas. Follow-up: CRA performance benchmarks should be rigorous, yet achievable, and the expectation should be that all banks can meet or exceed the established standard—as is the case with all other consumer protection and safety and soundness regulations. Do you agree that artificially high benchmarks could incentivize banks to engage in undue risk taking in order to comply with the regulation's performance standards?

Response: The proposed benchmarks and the data sources generally align with the standards examiners use today to evaluate bank retail lending performance, with some differences. Current CRA examinations compare bank lending to local demographic and peer lending data, as prescribed in the interagency examination procedures, to aid examiners in assessing bank performance. However, the current CRA regulations and examination procedures provide examiners discretion when evaluating bank lending in comparison to the local data points. While examiner judgment allows for tailoring to reflect local community needs, some stakeholders have noted that it can also lead to inconsistent outcomes.

The Agencies proposed to set performance thresholds as the lesser of the two calibrated benchmarks (community and market) to establish more consistent standards that the agencies believe are achievable everywhere, while still ensuring that the performance standards are set appropriately in markets in which low- and moderate-income individuals and census tracts, and small businesses and small farms, may be underserved.

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8. To address the development and proliferation of digital banking, the proposed CRA rule would create new Retail Lending Assessment Areas (RLAA) where a bank makes more than 100 mortgages or 250 small business loans.

    a. Question: Have the agencies analyzed where these new assessment areas would be created? If so, can you share that information with us? [Note: ABA's preliminary analysis using existing HMDA and CRA data finds that most RLAAs would be located in areas currently well-served by banks, which could add to the problem of hot-spots and not encourage CRA activities in underserved areas.

    Response: The FRB conducted an analysis to determine which banks would be affected and where and how many Retail Lending Assessment Areas would be created based on available data for the period 2017-2019. Table 1 to Section __.17 of the proposed rule illustrates the potential effect of different retail lending thresholds on large banks.[15] See Board of Governors of the Federal Reserve, *CRA Analytics Data Tables*, https://www.federalreserve.gov/consumerscommunities/data_tables.htm.

9. Cost/benefit analysis: The actual benefit to communities and consumers targeted by CRA should be measured against the substantial increase in regulatory burden.

    Question: How have the agencies determined that the proposal strikes this balance? Are there less burdensome alternatives that could accomplish this objective?

    Response: In the proposed rule, the Agencies sought to strengthen the achievement of the core purpose of the statute, which is to encourage banks to help meet the credit needs of the local communities in which they are chartered consistent with a bank's safe and sound operation, without imposing unnecessary regulatory burden.

    The Agencies specifically sought comment on whether this proposed tailoring approach appropriately balances the objectives of maintaining strong CRA obligations and recognizing differences in bank capacity, and whether there are other alternatives to better achieve this balance. We are reviewing these comments, along with other comments on the proposal.

10. Implementation period: The proposed one-year implementation period following publication of a final rule is too short given the complexity of the proposal and we believe a longer period is necessary. One year is not an adequate amount of time for banks to turn operations over to a new regime of requirements and collect and report the data required for benchmarking and comparisons.

[15] 87 FR33884, at 33920 (June 3, 2022).

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Question: Given these significant constraints, will the agencies consider a longer implementation period?

Response: The Agencies received many comments on the proposed implementation period for a final rule, with many commenters expressing a similar view, that the rule is too complex to implement in the time period proposed. We are reviewing the comments received on this issue, along with other comments.

11. Performance standards: At a June 6 forum sponsored by the Urban Institute, FDIC Chair Martin Gruenberg said the following: "Raise the bar for performance, meaning, what a bank did before to earn an Outstanding or High Satisfactory will not be sufficient. They will have to engage in more lending activity to earn the recognition. The goal is more lending to more low- to moderate-income communities." Banks already make great efforts to serve their communities through CRA, but Mr. Gruenberg's statement implies that banks are not doing enough.

    Question: Why do the agencies believe the bar needs to be raised for CRA performance? A 125% threshold for Outstanding performance will practically eliminate the opportunity for banks with significant market share in any market to achieve an Outstanding rating in that market. How and why were the thresholds established?

    Response: Concerns have been expressed in recent years regarding CRA "grade inflation" and through the proposal the Agencies seek to ensure that banks meet CRA objectives by serving their local communities, including low- and moderate-income individuals and communities. The agencies last made major interagency revisions to the CRA regulations in 1995. Changes in bank operations and consumer access to financial services necessitate changes to the regulation to satisfy the core purpose of the statute.

12. Thresholds: While we understand the agencies have given some background to the reasoning for the specific thresholds (p 33919), we believe the proposed mortgage and small business loan thresholds for delineating retail lending-based assessment areas need to be increased or include other modifications. As proposed, many banks would have increased assessment areas far beyond current requirements (e.g., one institution in our membership would have a 700% increase in assessment areas). As a possible unintended consequence, these low thresholds may lead to reduced lending, leaving borrowers with few options.

    a. Question: Have the agencies considered the possible consequences of banks pulling out of certain possible assessment areas due to the impracticality of adding additional countywide MSAs due to low volume thresholds?

    b. Question: Have the agencies considered alternatives to the proposal including on national out of footprint area?

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Response: The agencies are currently reviewing comments related to retail lending assessment areas, including suggested alternatives to the loan thresholds and how these assessment areas should be considered within the Retail Lending Test.

13. Retail lending test: Several areas of the proposal do not fully account for the transition of the industry toward digital delivery channels, especially for banks that primarily or exclusively serve customers through digital channels. For example, it is unclear how a digital bank could pass the Retail Services and Products Test given the test's focus on branch distribution. Additionally, the Retail Lending Test is tied to specific geographies, but in practice, digital lending is not related to any specific geography, meaning many digital banks will be scrutinized under the RLT simply because they happened to make 100 mortgage or 250 small business loans in a given geography.

    Question: Will the agencies consider further tailoring the rule to account for digital banks?

    Response: The proposal provides for examiner discretion on a large bank's performance under the Retail Services and Products test, including consideration of a large bank's digital delivery systems at the institution level. The agencies requested comment on more quantitative and standardized approaches to weighting the three parts of the digital delivery systems evaluation. The agencies also requested comment if this is the appropriate method to account for banks with no or few branches and significant digital operations.

    Additionally, the proposed approach of designating retail lending assessment areas is designed to provide a pathway to evaluate banks in a way that provides parity between banks that lend primarily through branches and those banks with different business models. Designating new retail lending assessment areas would ensure that, regardless of delivery channel, large banks would have evaluations of their retail lending in the local markets where they conduct significant retail lending business.

14. Strategic plans: The strategic plan option in the proposal seems less flexible than under the current CRA framework, and the agencies seem to be backing away from an option they have often asked banks to consider under the current framework. The proposal contains very little information about when a strategic plan might warrant flexibility with respect to the otherwise applicable standards and does not detail the extent of the available flexibility.

    Question: Since the proposed strategic plan option would not be much different from evaluation under the relevant performance test, will the agencies provide some transparency on how the strategic plan option will maintain flexibility for banks that do not fit into the conventional retail framework, such as digital banks and banks focused on consumer lending?

    Response: The proposed strategic plan framework would allow banks that are substantially engaged in activities that are outside the scope of the standard performance tests to set different metrics or goals than the majority of banks. The bank would be required to explain

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why those metrics or goals are appropriate. The agencies would consider whether those metrics or goals are responsive to the characteristics and credit needs of its assessment areas and consider public comment and the bank's capacity and constraints.

The Agencies received many comments on the proposed strategic plan provisions, including comments from banks that do not fit into the conventional retail framework that are concerned about the flexibility of the proposed strategic option. We are reviewing these comments, along with other comments on the proposal.

15. Indirect lending: In an indirect lending scenario, banks have little contact and little discretion targeting LMI borrowers.

    Question: Have the agencies considered excluding indirect auto loans, or other types of indirect financing including equipment, RV, marine, etc., from the auto lending evaluation?

    Response: The Agencies are currently reviewing comments related to which primary products to consider within the Retail Lending Test and whether to consider indirect auto lending if it is retained as a primary product. We are reviewing all of these comments.

16. More than half American consumers are finding it difficult to meet emergency financial needs according to a recent GAO study. Over the last decade, there have been 19 regulatory actions pertaining to small dollar lending, many of which have all but killed the small dollar market for depository institutions and pushed consumers to the less regulated and less supervised alternative lending markets like payday lenders. As noted by the GAO, many depository institutions are hesitant to dedicate the resources needed to adequately develop small-dollar products that will help consumers meet their monetary shortcomings.

    a. Question: Do you believe there is a need for small dollar loan product offered by highly regulated depository institutions?

       Response: National banks and federal savings associations are well positioned to provide responsible small-dollar loans with reasonable pricing and repayment structures. Moreover, small-dollar loan products offered by regulated depository institutions could increase market competition and lead to product alternatives for consumers that are lower cost or provide more favorable terms.

       Due in part to the potential benefits of small-dollar loans offered by regulated depository institutions and as reflected in OCC Bulletin 2020-54, the OCC, along with the Federal Reserve Board, FDIC, and NCUA, transmitted the "Interagency Lending Principles for Offering Responsible Small-Dollar Loans" on May 20, 2020. As reflected in these principles, the agencies recognize the important role that offering small-dollar loans in a responsible manner can play in helping customers meet their ongoing credit needs due to temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, national

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emergencies, or disaster recoveries. Through the principles, the agencies encourage financial institutions to offer responsible small-dollar loans to consumers and small businesses.

In addition, on March 26, 2020, and as reflected in OCC Bulletin 2020-25, the OCC, along with the Federal Reserve Board, CFPB, FDIC, and NCUA, transmitted the "Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19," which states that federally supervised financial institutions are well-suited to meet the credit needs of customers affected by the COVID-19 emergency and specifically encourages financial institutions to offer responsible small-dollar loans to both consumers and small businesses.

b. Question: Do you believe it is important for the banking agencies to coordinate small dollar lending policies? What are you doing to facilitate that?

   Response: Interagency collaboration and coordination promote clarity and consistency among examiners and stakeholders, and, through productive interagency efforts, the agencies have considered the role of small-dollar loans. For instance and as reflected in OCC Bulletin 2020-54, the OCC transmitted the "Interagency Lending Principles for Offering Responsible Small-Dollar Loans" alongside the Federal Reserve Board, FDIC, and NCUA. In addition, the OCC also participated with the Federal Reserve Board, CFPB, FDIC, and NCUA in issuing the "Joint Statement Encouraging Responsible Small-Dollar Lending in Response to COVID-19."

Imposing Liability on Banks for Authorized P2P Payments to Scammers

17. There have been rumors that the CFPB is planning to shift liability for P2P payments that consumers make to a scammer. Obviously, scammers will profit from such a policy because, armed with an official government document, they will be able to induce people to pay them by telling them there is no risk in sending the money –even if the circumstances are suspicious. However, banks, unlike the consumer, would have no insight into the transaction to be able to stop it.

    Question: Are you concerned about: The impact on bank safety and soundness given banks' inability to identify or stop the fraud and the size of potential fraud losses banks would incur? The impact on competition if small banks in particular cannot offer the product because the risk of loss is too much to bear? The harm to consumers if banks begin charging for these very popular services, limiting access to the product, or adjusting the model to reduce the potential for fraud loss (i.e., imposing delays in consumer access to the money or limiting transaction amounts or the number of transactions), which will reduce the value or appeal of P2P services?

    Response: The OCC is aware of concerns with malicious actors targeting customers with fraud on popular P2P platforms. For example, in the OCC 2022 Fall Semiannual Risk

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Perspective, the OCC noted that there is heightened fraud risk associated with many of the innovative P2P platforms. The OCC has emphasized the importance of fraud prevention for P2P payments and other payment channels. On July 24, 2019, the OCC issued fraud risk management guidance to banks on managing fraud risk, through its OCC Bulletin 2019-37, "Operational Risk: Fraud Risk Management Principles." Fraud can be committed in various ways, and fraudsters are using increasingly complex forms of social engineering to convince people to initiate transactions and send money via a P2P service. Banks should have a sound risk management system and an effective system of internal controls in place to detect, prevent, and respond to fraud attempts on a timely basis.

The OCC recognizes that the payment systems environment and fraud threats are highly complex, and different potential solutions can raise complex policy and legal considerations for banks, non-bank financial institutions, and consumers, as well as regulators. The OCC is committed to engaging with the CFPB, other banking agencies, consumer groups, and industry stakeholders to understand and address these ongoing issues and strengthen payment systems safeguards for financial institutions and their customers.

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Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Senator Steve Daines:

1. At the November 17th public meeting of the U.S. Department of the Treasury's Financial Literacy and Education Commission (FLEC), you stated that "continued improvements need to be made" in digital asset regulation.

    a. Question: What "improvements" does the OCC recommend to improve the trustworthiness of crypto/digital asset markets?

        Response: Last year, the OCC articulated a "careful and cautious" approach to crypto activities for the financial institutions it supervises . This approach largely prevented recent stress and dislocation in the crypto sector from having a contagion effect in the national banking system. We intend to continue this careful and cautious approach. On January 3, 2023, the federal banking agencies issued a statement highlighting key risks for banking organizations associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[11] We will continue to collaborate and coordinate with other financial regulators to identify and mitigate risks that crypto-assets may pose to the financial system. This collaboration is especially important given that crypto businesses generally are not subject to comprehensive supervision where a single financial regulator has a line of sight into a firm's aggregate activities. These interagency efforts also include work related to consumer protection.

2. On October 27, the OCC announced the establishment of an Office of Financial Technology that will begin operating early next year.[12] The new office will "build on and incorporate the Office of Innovation" which was formed to coordinate financial innovation efforts across agencies.

    a. Question: What implications will the Office of Financial Technology's incorporation of the Office of Innovation have on the OCC's ability to regulate markets and promote American innovation?

        Response: As announced on October 27, 2022, the OCC will establish the Office of Financial Technology, which will further bolster the agency's expertise and understanding of the changing banking landscape, enabling the OCC to be more agile and to promote responsible innovation, consistent with the OCC's mission. We anticipate opening this new Office in 2023.

    b. Question: Will the Office of Financial Technology's main priority be "responsible financial innovation" or is there another core objective?

[11] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.
[12] https://www.pymnts.com/cryptocurrency/2022/occ-head-hsu-praises-careful-cautious-approach-crypto/.

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Response: The Office of Financial Technology will enable the OCC to continue to promote responsible innovation and will build upon and incorporate the OCC's Office of Innovation, which the OCC established in 2017 to coordinate agency efforts to support responsible financial innovation. The new Office of Financial Technology will also provide strategic leadership, vision, and perspective for the OCC's financial technology activities and related supervision. It will bolster the OCC's expertise and ability to adapt to the rapidly changing banking landscape. To ensure that the federal banking system is safe, sound, and fair today and well into the future, we need to maintain a deep understanding of financial technology and the financial technology landscape.

3. Speaking at the DC Blockchain Summit on May 24th, you mentioned that "too many consumers have been influenced by the hype promoted in crypto's online community"[13].

   a. Question: Has the OCC produced any policy proposals that aim to reduce or eliminate illegal "pump and dump" schemes that are often propagated by the online influencers you referenced? If not, what would does the OCC view as the appropriate federal agency to craft these proposals?

      Response: The OCC shares your concerns regarding the significant amount of fraud related to the crypto sector. The OCC is considering how to incorporate applicable recommendations in the recently issued Treasury Report, *Crypto-Assets: Implications for Consumers, Investors, and Businesses* (treasury.gov). The OCC is also collaborating with other members of the Financial Literacy and Education Commission (FLEC) to promote consumer protections and to provide consumers and financial educators access to more free and trustworthy information about crypto-assets on the mymoney.gov website, promote consumer awareness about how to avoid frauds and scams, and ensure consumers know where to go if they encounter one.

      The federal banking agencies recently issued a joint statement highlighting risks associated with crypto-assets and the crypto-asset sector and describing the agencies' approaches to supervision in this area.[14] Among other risks, the statement noted the risk of scams and frauds among crypto-asset sector participants.

      The OCC's Customer Assistance Group (CAG) has begun tracking complaints received by the OCC from customers of OCC-supervised institutions relating to crypto and other digital assets. The OCC will continue to monitor crypto-related developments and will take appropriate actions to address activities of OCC-supervised institutions.

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[13] https://www.pymnts.com/bank-regulation/2022/crypto-economy-is-dependent-on-hype-says-occs-comptroller/.
[14] https://www.occ.treas.gov/news-issuances/news-releases/2023/nr-ia-2023-1a.pdf.