OVERSIGHT OF PRUDENTIAL REGULATORS

HEARING

BEFORE THE

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U.S. HOUSE OF REPRESENTATIVES

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TUESDAY, MAY 16, 2023

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OVERSIGHT OF PRUDENTIAL REGULATORS

Tuesday, May 16, 2023

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

The committee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Patrick McHenry [chairman of the committee] presiding.

Members present: Representatives McHenry, Sessions, Posey, Luetkemeyer, Huizenga, Wagner, Barr, Hill, Loudermilk, Mooney, Davidson, Rose, Timmons, Norman, Meuser, Fitzgerald, Garbarino, Kim, Flood, Lawler, Nunn, De La Cruz, Houchin, Ogles; Waters, Velazquez, Sherman, Meeks, Scott, Lynch, Green, Cleaver, Himes, Foster, Beatty, Vargas, Gottheimer, Gonzalez, Casten, Pressley, Horsford, Tlaib, Torres, Garcia, Williams of Georgia, Nickel, and Pettersen.

Chairman MCHENRY. The Financial Services Committee will come to order.

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

Today's hearing is entitled, "Oversight of Prudential Regulators." And I am now going to recognize myself for 4 minutes for an opening statement.

I want to thank our witnesses for testifying today. You are here at a pivotal moment for our economy. The recent turmoil in the banking sector could not come at a worse time. The Biden Administration and many of my colleagues on the other side of the aisle and the Capitol want to treat the symptoms rather than the disease.

Our country is suffering from an inflation problem, plain and simple. Driven by the economic mismanagement of this Administration, inflation is the underlying cause of the volatility we are experiencing now.

My Democratic colleagues will roll their eyes just like they did every time Republicans sounded the alarm on skyrocketing prices over the past 2 years. But let me walk you through it. When Democrats forced through their partisan $2-trillion so-called American Rescue Plan, they lit the fuse on runaway inflation. Instead of addressing this problem, the Biden Administration went on a roadshow trying to explain away higher prices. They used words like, "transitory," which, to be frank, didn't age well.

The Federal Reserve was late to the game in responding to inflation, and they admit it. They had to play catch-up and raise interest rates 500 basis points at the fastest pace in modern history.

This injected heightened interest rate risks into the financial system. Regulators and supervisors at the Fed were, again, late to react.

Now, 3 of the 30 largest banks have been shuttered. There is still market volatility within regional banking. And we are now staring down a credit crunch as banks of all sizes anticipate more-onerous regulations and market scrutiny.

Let me be clear: If Congress and this Administration do not respond correctly, we are just at base camp for the economic woes our country could face. A one-size-fits-all regulatory response to this crisis, which has been signaled by this Administration, will work against promoting a vibrant banking system, with institutions of all sizes providing a variety of services.

Instead of a balanced system with small, medium, and large institutions, it will look more like a barbell banking system with dominant, too-big-to-fail banks as anointed by the Dodd-Frank Act and government backstops on one end, and a scattering of very small banks relying on government subsidies to survive on the other end. Such a barbell banking system, with a missing middle of healthy regional banks, is not good for communities across America.

Vice Chair Barr, you have signaled your desire to go beyond reviewing the supervisory failures that contributed to the recent bank failures. You have used this crisis to justify progressives' long-held priority to increase capital requirements and impose new regulations on banks. That predates this crisis, but you are using this crisis to justify your prebaked ideas.

The Fed's internal review, along with the FDIC's report and recommendations on deposit insurance, lay bare the playbook for this Administration's response to this crisis: more regulation, more government control, and more spending.

I know my colleagues across the aisle will use today's hearing to discuss the debt ceiling, and I welcome that debate. We serve in the only institution that has actually addressed the debt ceiling, but frankly, I think what we have now is a larger debate about the economy, not just about the debt ceiling. And inflation and spending are the reasons why we are dealing with the debt ceiling at this time. So, I am glad that we acted, and the House of Representatives acted, and the President has now finally come to the table to negotiate with the Speaker.

But the out-of-control Washington spending that led to this uncertainty that we are feeling in banking, that the American families are experiencing, is the result of spending out of Washington, and Republicans are working to address that spending issue.

I now recognize the ranking member of the committee, Ms. Waters, for 4 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Good morning, everyone. First, I would like to welcome our banking and credit union regulators who are here to testify before our committee today.

On the heels of the collapse of Silicon Valley Bank, Signature Bank, and most recently, First Republic, it has been the swift action by regulators, in conjunction with the Biden Administration, that have not only protected depositors from harm but ensured the

safety of the United States banking system. Americans can continue to rest assured that despite the recent events, their money is safe, and that none of the actions taken by our regulators will cost U.S. taxpayers a single dime.

Recently-released reports from our nation's regulators confirm that Democrats have long been sounding the alarm on a toxic combination of Trump-era deregulation, and mismanagement by irresponsible bank executives and board members, which caused the recent bank failures.

While regulators must be more aggressive in their supervision of banks, it is the responsibility of bank executives, first and foremost, to take corrective action when regulators identify deficiencies. Since 2018, executives from both Silicon Valley Bank and Signature Bank received multiple warnings, but they ignored those warnings and did not take action. These bank CEOs didn't just run their banks into the ground; they also put our nation's depositors and our entire economy in jeopardy.

Unfortunately, rather than take action to hold these bank CEOs accountable and work in good faith to get to the bottom of the recent failures, Republicans are using this hearing as an opportunity to point the finger at regulators. Republicans do not appear interested in crafting legislation that would address the regulatory gaps and weaknesses exposed by these recent failures.

Instead, they have proposed a slew of bills focused on so-called transparency, completely and willfully ignoring the fact that regulators have published extensive reports and shared other materials that take a deep dive into the failures and the emergency responses. In addition, several of the Republican bills would limit emergency tools regulators just used to stabilize the situation, making it harder for them to respond to future emergencies.

However, our committee will finally hold its first hearing with the Silicon Valley Bank, Signature Bank, and First Republic Bank executives tomorrow, after Democrats repeatedly pleaded to Republicans. But I remain deeply disappointed that we are holding such an important hearing at the subcommittee level, which means fewer Members will be there to get answers for their constituents, and there will be fewer questions, and a shorter hearing. Unfortunately, my request to Chair McHenry to hold this at the Full Committee level has not been fulfilled.

This is a stark difference from the leadership Democrats have demonstrated during this time. Through briefings, letters, and policy solutions, committed Democrats are the only ones working around the clock to get answers for the American people and hold the bank CEOs to task. I urge my Republican colleagues to finally join us in this effort.

So, I look forward to this hearing, I thank you, and I yield back the balance of my time.

Chairman MCHENRY. The Chair now recognizes the gentleman from Kentucky, Mr. Barr, who is also the Chair of our Financial Institutions Subcommittee, for 1 minute.

Mr. BARR OF KENTUCKY. Thank you, Mr. Chairman.

Today's hearing is especially timely, given recent bank and supervisory failures. Rather than providing timely responses to questions from this committee, the Fed and the FDIC decided to

produce public-facing reviews of their supervisory shortcomings and push inept policy recommendations. Failure to timely respond to this committee's questions represents a lack of transparency and accountability. As of last night, we still had not received responses from Mr. Barr or Mr. Gruenberg from a March 29th hearing, even though responses were requested to be in by April 28th.

Regulators should not race to set narratives in the minds of the American people. The report by Vice Chairman Barr accurately highlighted the idiosyncratic nature of the SVB business model, but it does not justify imposing new onerous and complex regulations on banks that have experienced deposit outflows through no fault of their own.

In the face of a growing credit crunch and the risk of a recession, moving rapidly to increase capital requirements on an already-well-capitalized banking system would be a mistake. We want to avoid a barbell banking system, with a few too-big-to-fail banks and a scattering of small banks. To do so, regulators should not be blocking mergers and acquisitions, imposing excessive——

Chairman MCHENRY. The gentleman's time has expired.

Mr. BARR OF KENTUCKY. ——regulations on regional banks, or imposing burdensome requirements that hinder de novo banks. I yield back.

Chairman MCHENRY. I now recognize the gentleman from Illinois, Mr. Foster, who is also the ranking member of our Subcommittee on Financial Institutions, for 1 minute.

Mr. FOSTER. Thank you.

In recent years, neuroscientists have understood that the human brain does much of its learning not just by living in the moment and observing cause and effect, but by replaying events of the recent past, both as they occurred and as they could have occurred with different behavior of the participants.

So the questions for today's hearing are not only what actually happened during recent bank failures, but also, what are the rules and incentives that, had they been in place, would have caused these failed banks to diversify their depositor base, to appropriately hedge their interest rate risk, and to raise capital early while they still could?

I was also encouraged by Vice Chair Barr's reiteration in his written testimony that major rule changes coming out of this episode, as well as presumably out of the holistic capital review and Basel III Endgame, will take place at a measured pace, with opportunity for input from both Congress and industry. This is important since the rule changes will have large effects not only on safety and soundness, which is your bailiwick, but on bank consolidation, which is very much ours.

Thank you, and I yield back.

Chairman MCHENRY. The gentleman yields back.

Today, we welcome the testimony of the Honorable Michael S. Barr, the Vice Chair for Supervision at the Federal Reserve Board of Governors; the Honorable Martin J. Gruenberg, the Chairman of the Federal Deposit Insurance Corporation; Mr. Michael J. Hsu, the Acting Comptroller of the Office of the Comptroller of the Currency; and the Honorable Todd M. Harper, the Chairman of the National Credit Union Administration.

We thank each of you for your time. Each of you will be recognized for 5 minutes for an oral presentation of your testimony. And without objection, each of your written statements will be made a part of the record.

Mr. Barr, you are recognized for 5 minutes.

STATEMENT OF THE HONORABLE MICHAEL S. BARR, VICE CHAIRMAN, SUPERVISION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM (FED)

Mr. BARR. Chairman McHenry, Ranking Member Waters, and members of the committee, thank you for the opportunity to testify today.

Overall, the U.S. banking system remains strong and resilient, and depositors should feel confident that all deposits in our banking system are safe. At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks.

My review of Silicon Valley Bank's (SVB's) failure demonstrates that there are weaknesses in regulation and supervision that should be addressed, and I am committed to doing so. I am also committed to maintaining the strength and diversity of the banking system so that it can continue to provide financial services and access to credit for households and businesses.

As we consider adjustments to our rules and supervisory practices, I am sensitive to how changes may affect banks in the current economic environment. My written testimony and accompanying supervision and regulation report provide details on conditions in the banking sector, and supervisory and regulatory efforts of the Federal Reserve over the last 6 months.

Let me turn to the SVB review. Immediately following SVB's failure, I led a review of the Federal Reserve's supervision and regulation of the bank. The resulting report takes an unflinching look at the conditions that led to the bank's failure, including the role of Federal Reserve supervision and regulation.

There are four key takeaways from the report. First, SVB's Board of Directors and management failed to manage the bank's risks. Second, Federal Reserve supervisors did not fully appreciate the extent of the vulnerabilities as SVB was growing in size and complexity. Third, when supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that the bank fixed those problems quickly enough. Fourth, the Board's tailoring approach impeded effective supervision by reducing standards, increasing complexity, and promoting a less-assertive supervisory approach.

The four key takeaways show failures by SVB's board and senior management and failures by the Federal Reserve.

Next, I will briefly outline how we can strengthen both our regulation and supervision based on what we have learned and based on the Federal Reserve's existing authorities.

On the regulatory side, SVB's failure confirms the importance of strong levels of bank capital. While the approximate cause of SVB's failure was a liquidity run, the underlying issue was concern about its solvency. Stronger capital will guard against the risks that we

may not fully appreciate today and will also reduce the costs of bank failures.

In addition, we need to reconsider some of our prudential requirements. These include evaluating how we treat available-for-sale securities in our capital regulations, how we supervise and regulate a bank's management of interest rate risk, how we supervise and regulate liquidity risk, and how we oversee incentive compensation practices.

Any adjustments to our rules would, of course, go through normal notice-and-comment rulemaking and have appropriate transition periods.

I also plan to improve the speed, force, and agility of supervision. Supervision should intensify at the right pace as a bank grows in size or complexity. Once identified, issues should be addressed more quickly, both by the bank and by supervisors. Moreover, we need to ensure that we have a culture that empowers supervisors to act in the face of uncertainty.

I want to reiterate that the banking system remains strong and resilient. Recent events demonstrate that we, as regulators, must do better, and we will.

Thank you, and I look forward to your questions.

[The prepared statement of Vice Chairman Barr can be found on page 78 of the appendix.]

Chairman MCHENRY. I now recognize Chairman Gruenberg for 5 minutes.

STATEMENT OF THE HONORABLE MARTIN J. GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION (FDIC)

Mr. GRUENBERG. Thank you, Mr. Chairman.

Chairman McHenry, Ranking Member Waters, and members of the committee, thank you for the opportunity to appear at today's hearing on oversight of prudential regulators.

The U.S. banking industry has proven to be quite resilient during this recent period of stress. Early reports from the first quarter of 2023 indicate that first-quarter aggregate bank net income was roughly unchanged compared to the fourth quarter, excluding the effects on acquirers' incomes of their acquisitions of failing banks. In addition, asset quality metrics remain favorable, and the industry remains well-capitalized.

Recent declines in medium- and long-term interest rates have reduced somewhat the volume of unrealized losses on securities. Still, insured depository institutions will continue to face significant challenges in the near term. Risks to the outlook include the potential for weakening credit quality and profitability that could result in further tightening of loan underwriting, slower loan growth, and higher provision expenses.

Commercial real estate loan portfolios, particularly loans backed by office properties, face challenges should demand for office space remain weak and property values continue to soften. The FDIC continues to monitor liquidity closely, including deposits trends across the banking industry, and will publicly release data for the first quarter of this year as part of its Quarterly Banking Profile later this month.

Last week, the FDIC Board of Directors approved a Notice of Proposed Rulemaking providing for the special assessment required by law to recover the loss to the Deposit Insurance Fund attributable to covering the uninsured deposits of Silicon Valley Bank and Signature Bank. Under that proposed rule, the FDIC would apply an annual special assessment rate of about 12.5 basis points to an assessment base that would equal an insured institution's estimated uninsured deposits reported as of December 31, 2022. The assessment is defined in such a way that no banking organizations with total assets under $5 billion would be subject to the special assessment.

On May 1st, the California Department of Financial Protection and Innovation appointed the FDIC as receiver for First Republic Bank. The FDIC was able to market and sell First Republic concurrently with its closure by entering into a purchase and assumption agreement with JPMorgan Chase following a competitive bidding process to assume all of the deposits and substantially all of the assets of First Republic. The FDIC estimates that the failure of First Republic will cost the Deposit Insurance Fund about $13 billion.

Notwithstanding the 3 recent bank failures, the FDIC currently expects that the Deposit Insurance Fund will remain on track to meet its statutory reserve ratio by September 30, 2028, without further adjustments to assessment.

The FDIC recently released two reports, one on the FDIC's supervision of Signature Bank, and one on options for deposit insurance reform.

The report on Signature Bank, conducted by the FDIC's Chief Risk Officer, found that the root cause of Signature's failure was poor management but also identified areas where the FDIC's supervisory efforts could have been more timely, forward-looking, and forceful, findings that will be matters of close attention by the FDIC.

The report on options for deposit insurance reform identified increased targeted coverage for business payment accounts as capturing many of the financial stability benefits of expanded coverage while mitigating the moral hazard effects.

Finally, the failures of Silicon Valley Bank and Signature Bank demonstrate the implications that banks with assets of $100 billion or more can have for financial stability. The prudential regulation and supervision of these institutions merit additional attention, particularly with respect to capital liquidity and interest rate risk.

My prepared testimony goes into all of these issues in considerable detail. The FDIC remains committed to engaging with the public, industry stakeholders, and Members of Congress on the policies and priorities outlined in the testimony.

That concludes my statement, and I would be glad to respond to questions.

[The prepared statement of Chairman Gruenberg can be found on page 85 of the appendix.]

Chairman MCHENRY. Thank you, Mr. Gruenberg.

Mr. Hsu is now recognized for 5 minutes.

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

Mr. HSU. Thank you, Mr. Chairman.

Chairman McHenry, Ranking Member Waters, and members of the committee, I am pleased to appear today to offer my observations about the recent market stress and to answer any questions you may have regarding the activities and priorities of the OCC.

Since March, I have worked especially closely with my peers at the other banking agencies to maintain financial stability and confidence in the banking system. Adequate levels of capital going into the recent turmoil have helped to limit the risk of contagion. Despite the market stress, the Federal banking system has remained resilient, and national banks and Federal savings associations have remained well-positioned to serve their customers.

None of the four large banks that failed were regulated by the OCC. Notwithstanding that, we are closely monitoring the conditions of the institutions we supervise and working with them to ensure that their liquidity and capital positions remain sound so that they are on the balls of their feet with regard to risk management.

Many have taken steps to reduce risk in light of market conditions. To date, the vast majority of OCC-supervised banks have not experienced stress with regards to their depositors or business customers.

Over the past 2 years, I have consistently emphasized to bankers the importance of guarding against complacency and of having strong risk management policies and practices in place. Most OCC-supervised banks have heeded this message and successfully navigated the rise in interest rates and changing economic outlook. OCC examiners will continue to actively monitor market conditions and engage with banks to help ensure that they are prepared to meet future challenges.

Based on my perspective as Acting Comptroller, and 20 years of experience as a financial regulator, I want to share some observations on steps that can be taken to restore full confidence in the banking system.

First, supervisors need support to act in a timely and effective manner. Supervisors at the OCC and the other banking agencies play a critical role in keeping the banking system safe and sound by exercising discretion. The degree to which supervisors feel empowered to exercise that discretion impacts their will to act in a timely and forceful manner. Clear support to empower supervisors to exercise discretion and act when needed will help keep the banking system safe and sound.

Second, regulations regarding the resilience and resolvability of large banks need to be strengthened. Stronger resiliency requirements for large banks with regard to capital liquidity would have reduced the probability of recent bank failures. Stronger resolvability requirements would have facilitated orderly failures with less government involvement. The OCC is working closely with the Federal Reserve and the FDIC to address these issues.

Third, deposit insurance coverage should be updated. The FDIC's recent report on deposit insurance is worth careful consideration, especially its conclusion regarding targeted expansion.

In the meantime, we have been working with our banks, especially those with significant levels of uninsured deposits, to ensure that their cash-holding and borrowing capacity can meet depositor withdrawals. We remain committed to supervising banks so that depositors can rest assured that their money is safe.

Finally, the diversity of the banking system must be preserved as the industry evolves. The OCC has been working on updating the analytical frameworks related to the bank merger guidelines that the Federal banking agencies and DOJ must follow when considering bank mergers. The recent turmoil has increased the urgency of these efforts.

The OCC is committed to being open-minded when considering merger proposals, and to acting in a timely manner on applications, consistent with the requirements of the Bank Merger Act. As the industry evolves, I strongly believe that we must preserve the diversity of the banking system, from community banks to mid-sized banks to regional banks.

Going forward, continued industry and regulatory vigilance is critical. Banks and supervisors must be attentive to the most salient risks today as well as those beyond the daily headlines. That will help ensure that the banking system remains a source of strength to the U.S. economy.

Thank you. I would be happy to answer any questions.

[The prepared statement of Acting Comptroller Hsu can be found on page 128 of the appendix.]

Chairman MCHENRY. The Chair now recognizes Chairman Harper for 5 minutes.

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

Mr. HARPER. Chairman McHenry, Ranking Member Waters, and members of the committee, thank you for the invitation.

My written testimony outlines the state of the credit union industry, some of the NCUA's recent efforts to strengthen the system, and several legislative requests. So, I will focus here on only a few key issues.

Overall, the performance of federally-insured credit unions remains stable. Total loans, assets, insured shares, and deposits all increased during the last year. The system's aggregate net worth ratio also rose to 10.75 percent, representing a recovery of 73 basis points from its pandemic low. What's more, 91 percent of total share deposits within the system are insured, which has contributed to stability within the credit union sector in recent months.

The NCUA's Share Insurance Fund also continues to perform well. Although the fund's equity ratio is 3 basis points below the desired operating level, no premiums are expected at this time. That is because the system is currently well-positioned to handle any dislocation resulting from a moderate recession.

Nevertheless, during the last year we have experienced growing interest rate and liquidity risks within the system, including at several billion-dollar-plus institutions. Aggregate cash positions have declined and are below pre-pandemic levels as well. Further, unrealized losses in securities limit their utility as a source of liquidity.

The recent increase in these risks underscores the value of the NCUA's Central Liquidity Facility (CLF), which acts as a shock absorber to contain or avert liquidity crises before they escalate. However, with the termination of the temporary CLF statutory enhancements last December, more than 3,000 credit unions with less than $250 million in assets lost access to the CLF, contracting the facility's capacity by almost $10 billion. With risks rising within the financial system and at individual credit unions, now is not the time to cut a liquidity lifeline.

As such, the NCUA board fully supports restoring the ability of corporate credit unions to serve as a CLF agent on behalf of a subset of their members. Notably, the Congressional Budget Office has scored this at no cost to the taxpayer.

Additionally, with increased concentration, intensifying cyber threats, and greater outsourcing of core business functions, the Government Accountability Office (GAO), the Financial Stability Oversight Council (FSOC), and the NCUA's Inspector General have all recommended congressional action to restore the NCUA's statutory examination authority over third-party vendors. I fully agree and respectfully request that Congress close this growing regulatory blind spot.

Lastly, the NCUA defers to Congress on determining what statutory changes, if any, should be made to deposit insurance coverage levels and account types. But if Congress does act in this area, the NCUA has two requests. First, we ask that Congress maintain parity between the share insurance coverage provided by the NCUA and the deposit insurance coverage provided by the FDIC.

And second, because an expansion in coverage will generally increase resolution costs, the NCUA requests greater flexibility for administering the Share Insurance Fund. This flexibility, which would be more in line with the FDIC's current administrative powers, includes allowing the NCUA board to establish a higher normal operating level, and modifying the current limitations on assessing premiums. Together, these changes would better enable the NCUA to build reserves during economic upturns so that sufficient money is available during economic downturns.

In sum, the credit union system currently remains well-capitalized, stable, and well-positioned to handle a relatively broad range of economic outcomes, and the NCUA stands ready to respond to any economic uncertainty and will continue to work through the supervisory process with individual credit unions experiencing problems.

Consumers, therefore, should remain confident that their insured share deposits at federally-insured credit unions are safe. And the NCUA stands ready to work with Congress on any legislative reforms to safeguard and strengthen the system.

Thank you again. I look forward to your questions.

[The prepared statement of Chairman Harper can be found on page 116 of the appendix.]

Chairman MCHENRY. Thank you. And I want to thank the panel for their testimony.

I now recognize myself for 5 minutes for questions.

Vice Chair Barr, you created a report in which your supervisory staff reviewed the decisions of the supervisory staff in responding to these bank failures. What was the directive you gave to staff?

Mr. BARR. I asked staff who are not involved in the supervision of SVB to look at what went wrong. I told them that they would have full access to any materials they needed to make that assessment. I gave them full discretion to find the facts——

Chairman MCHENRY. Will you provide those same materials to the ranking member and me?

Mr. BARR. We have been working with your staff on a cooperative basis to provide materials, and we are happy to continue——

Chairman MCHENRY. It doesn't feel cooperative quite yet, but we will follow up on that. And so you are saying, yes, you will provide those internal documents?

Mr. BARR. We would be happy to continue to provide those documents. We have been providing them on an ongoing basis to committee staff.

Chairman MCHENRY. Okay. So, how did you select the staff?

Mr. BARR. The lead staff person for the report is the former head of New York supervision, the Federal Reserve Bank of New York supervision——

Chairman MCHENRY. What divisions were involved in that?

Mr. BARR. ——who has more than 25 years of experience, and he assembled a team from throughout the System, other than the San Francisco Fed.

Chairman MCHENRY. How many staffers worked on this report?

Mr. BARR. I'm sorry, sir?

Chairman MCHENRY. How many staffers worked on this report?

Mr. BARR. Approximately 20.

Chairman MCHENRY. Okay. From what divisions?

Mr. BARR. From throughout the Board and assistant supervision other than San Francisco Fed.

Chairman MCHENRY. Were other Reserve Banks involved?

Mr. BARR. Yes. Reserve Banks and Board staff were involved in the report.

Chairman MCHENRY. Okay. So, given that two of the three bank failures occurred under the San Francisco Fed's purview, is there a specific review of the San Francisco Fed's supervision?

Mr. BARR. We were reviewing Silicon Valley Bank. The other banks that failed were not subject to Federal Reserve supervision, so neither of those were part of our report. We were reviewing our supervision of Silicon Valley Bank only.

Chairman MCHENRY. In light of that, did the Board vote on this report? Did you give the Board a review of your report?

Mr. BARR. No, it is a report of the Vice Chair for Supervision under my statutory authorities. It was not a report of the Board.

Chairman MCHENRY. It was provided to the Board?

Mr. BARR. The Chair and other Board members were given a copy of it in advance.

Chairman MCHENRY. So, this is not something that the Board would vote on?

Mr. BARR. Correct.

Chairman MCHENRY. But other supervisory matters are taken to the Board for a Board vote?

Mr. BARR. It depends on the nature of the supervisory action. Daily course kind of examination work and so on don't rise up to that level. But if there is a formal enforcement action, for example, that would go to the Board for a vote.

Chairman MCHENRY. In your report, you talk about a cultural shift in supervision. How did you ascertain that there is a cultural shift?

Mr. BARR. The staff, as part of this review, spoke with the supervisors involved in this and with others in the system, and one aspect of one of the four findings of the report was that there was a shift in the tone of supervision.

Chairman MCHENRY. Was that done through, for example, an opinion survey of staff?

Mr. BARR. There was no survey. It was a set of interviews that were conducted as part of the report.

Chairman MCHENRY. Okay. So, you opine that there was a cultural change, and this is based off of a few interviews from a few staff from the San Francisco Fed in light of Silicon Valley Bank. And you report that there is a cultural change in supervision across the Federal Reserve in light of just this one regional bank. That is the conclusion you draw in your report.

Mr. BARR. The report's findings are solely related to Silicon Valley Bank.

Chairman MCHENRY. But you opine that there is a general cultural shift on supervision, and it is one of the key talking points coming out of the report. Does this mean that supervisors felt impeded from reporting up that there was a problem at a bank?

Mr. BARR. The report found that supervisors were more reluctant than they had been to escalate issues, yes, sir.

Chairman MCHENRY. Did they actually show up in the bank? Is that a bit of the problem, too, that the cultural shift could be that they are not in the banks on a regular basis, that there is more—could that be a part of the cultural shift?

Mr. BARR. One of the findings of the report is that the pandemic contributed to a reduction in supervisory intensity. That is a finding of the report.

Chairman MCHENRY. I would like to hear how you are going to remedy this, and we will have ongoing questions about this.

Obviously, in light of the tightness in the credit markets, and your additional capital requirements, we are going to have a lot more questions about that holistic review of capital.

With that, I recognize the ranking member of the committee, Ms. Waters, for 5 minutes.

Ms. WATERS. Thank you, Mr. Chairman.

Vice Chair Barr, while Republicans try to downplay any role that deregulation played in these regional bank failures, I was pleased when one of their witnesses at last week's hearing, Ms. Margaret Tahyar, conceded that there were regulatory improvements that should be considered. She commended the Fed's report on SVB's failure, and she specifically stated her support for two recommendations to address issues that were identified by the report: first, eliminating the delay when enhanced prudential requirements took effect after banks crossed the $100-billion threshold; and second, eliminating the bank opt-out from holding capital re-

garding their Accumulated Other Comprehensive Income, (AOCI), which includes a bank's securities portfolios with unrealized losses.

So, Vice Chair Barr, do you agree with these recommendations? Would you explain how this AOCI issue artificially inflates SVB's capital levels, making them appear safer than they really were?

Mr. BARR. Thank you very much, Ranking Member Waters.

I will speak to each of those in turn.

With respect to the issue of AOCI, this is basically a question of whether gains and losses on available-for-sale securities should flow through to the capital treatment of a bank. The initial rules that the Federal Reserve had in place applied those rules to a broader set of firms, beginning in 2013. That was narrowed to just being the G-SIBs in 2019, and the question is, what is the right way of addressing that going forward?

We are carefully considering making a change for firms over $100 billion that would pass that unrealized loss or gain through the capital treatment to more accurately reflect their financial condition. Any such rule change that we propose would go through normal notice-and-comment rulemaking and would have an appropriate transition period for implementation.

I also agree with the second issue you raised, which is about how to think about applying the heightened standards when a firm crosses the threshold. For example, in this case, with respect to SVB, the Federal Reserve's transition rules were themselves very complicated, and there was discussion among staff, supervisory staff, as well as the bank, about when those rules would actually apply.

And the effect of that was there was a significant delay in when enhanced prudential standards applied to the firm even under the tailoring approach, and that complexity and delay contributed, I think, to having weaker standards apply to the firm. So, we are quite focused on simplifying the transition rules and making sure that firms, when they cross that threshold, are able to be ready to apply those thresholds, those new standards when they cross the threshold.

Ms. WATERS. Thank you very much.

What you are referring to is basically how S. 2155 was crafted, and I want to know how much flexibility did you have in dealing with the deregulatory S. 2155 legislation?

Mr. BARR. The Federal Reserve has the discretion we need to change the approach we are using for firms over $100 billion in size. There is authority under the statute for us to make those changes, and we intend to use that authority as appropriate to make adjustments to our supervisory framework.

Ms. WATERS. So you are indicating that you don't need additional legislation to do that?

Mr. BARR. That is correct.

Ms. WATERS. And you agree with what has been said by Ms. Tahyar, in essence, that there is a need for us to deal with the whole issue of deregulation?

Mr. BARR. I do think it is important for us to look at the tiering approach that had been used for institutions of this size. Given what we just experienced with two FDIC-supervised institutions, these institutions had lower standards applied to them, so I think

it is important for us to look at that and see what changes need to be made.

Ms. WATERS. Are you looking at that now with our regionals and particularly our small regionals?

Mr. BARR. We are looking at firms, generally speaking, of $100 billion and above with respect to these changes.

Ms. WATERS. That have reached that level already?

Mr. BARR. I'm sorry?

Ms. WATERS. That have reached the level of $100 billion and above?

Mr. BARR. Correct.

Ms. WATERS. Thank you. I yield back.

Chairman MCHENRY. Mr. Hill is now recognized for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman.

And I want to thank the panel for their engagement with the committee and for your work with each of us on both sides of the aisle over the last few weeks in light of these recent failures.

Before I get to my questions, I think picking up where the ranking member left off is absolutely ideal in discussing S. 2155, and a lot of argument in this City that somehow it was a contributing factor to the failure of Silicon Valley Bank and potentially others. I think that argument just falls on its face. I base that on not only my work here in Congress, but on 40 years of being involved in regulated institutions.

It is just a talking point, not a material assessment. And Vice Chair Barr has absolutely just simply demonstrated to the whole committee precisely why that argument is not accurate, which is that the supervision of our financial system rests in the hands of these agencies, and they have full discretion to use their best judgment to deliver that supervision on a daily basis, whether it is in a particular regional bank in California or on a macro basis. And the Vice Chair says the statute has the authority to facilitate the proper execution of those statutory obligations, notwithstanding the modest reforms to Dodd-Frank that S. 2155 sought to make.

And we shouldn't throw the baby out with the bathwater on this issue about tailoring, because one of the complaints on both sides of the aisle about Dodd-Frank was that it was one-size-fits-all, and it did not tailor the capital, liquidity, and leverage requirements based on bank size and, more importantly, the risk profile of a bank.

Here, Silicon Valley is a large institution, but its risk profile was what was, I think, shocking when we look at the facts. The bottom line is we have real diversity in banking in our country. This is a strength. It differentiates our banking system from those around the world, and we need to preserve and enhance the diversity and strength of our banking system.

Crisis politics, trying to return to one-size-fits-all approaches to prudential regulation, in my view, will just exacerbate this challenge and make it harder to have a broad, diverse system. So, in my view, it wasn't S. 2155 or passing legislation—not passing that legislation would have in any way prevented this. It was clearly a failure of supervision and management.

Let me turn to a couple of areas of interest. First, Comptroller Hsu, you talked about having management up on the balls of their

feet assessing the marketplace. How do we have a sense of urgency among supervisors where they are up on the balls of their feet, which clearly they weren't in the case of Silicon Valley?

Mr. HSU. We have been on the balls of our feet. And at the OCC, every year we issue a Semiannual Risk Perspectives report, which highlights key risks that bankers, examiners should heed. And that report covers many of the risks that have been discussed in these hearings, as well as in the reports issued by the Fed and the FDIC.

Mr. HILL. Thank you. I appreciate that.

Looking at reconciliation of these institutions, Chairman Gruenberg, let me talk to you about source of strength. Holding companies deliver a major source of strength to their depository institutions, right?

Mr. GRUENBERG. Yes, sir.

Mr. HILL. We take that for granted to some degree. Is that true, that we just accept that that holding company is there?

Mr. GRUENBERG. Not all institutions, as you know, have holding companies.

Mr. HILL. Right.

Mr. GRUENBERG. But the system is set up for those that do. The holding companies expect——

Mr. HILL. Silicon Valley had a holding company?

Mr. GRUENBERG. It did.

Mr. HILL. Do you have a written agreement that that holding company provides a source of strength to the depository bank?

Mr. GRUENBERG. We were not the supervisor of Silicon Valley, and the Fed, as you know, is the holding company regulator. So, I think they would be——

Mr. HILL. No, but don't you have to have, as the FDIC, a written agreement with that bank holding company to provide a source of strength to the bank?

Mr. GRUENBERG. I believe that is a regulatory standard, Congressman, not something that we would have some sort of——

Mr. HILL. Can you provide me with a yes or no in writing about whether you and the Federal Reserve had a written supervisory agreement that the holding company of all the banks that have over 50 percent of their deposits in uninsured accounts—that they have a written agreement with the holding company? If they have a holding company to be a supervisor.

Mr. GRUENBERG. I would be glad to.

Mr. HILL. Yes, thank you.

I yield back.

Chairman MCHENRY. The gentlewoman from New York, Ms. Velazquez, is now recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

As all four of you are aware, Senator Van Hollen and I recently wrote to each of you regarding your rulemaking responsibilities under Section 956 of Dodd-Frank.

Vice Chair Barr, and Acting Comptroller Hsu, I am still awaiting your responses. And Chairman Harper, and Chairman Gruenberg, I found your responses to be a little lacking. So, let me ask each of you directly, since the fall of Silicon Valley and Signature Banks, what steps have each of your agencies taken to finalize this rule?

Have your agencies met with one another and the other regulators? And do you think the rule will be finalized by the end of the year?

Mr. Barr?

Mr. BARR. The agencies have met to discuss how to make progress on the Section 956 rulemaking.

Ms. VELAZQUEZ. Have you met with each other?

Mr. BARR. Yes, I'm sorry. The agencies have met together to discuss that matter. In terms of timing, the rule would need to go through a proposal and then a rulemaking.

Ms. VELAZQUEZ. I know. It has been 11 years already, 11 years. So, Mr. Gruenberg?

Mr. GRUENBERG. Yes, Congresswoman. As you know, there are six agencies involved in this rulemaking, the four that are represented at the table here, plus the SEC and the FHFA. I believe there is a strong commitment across the six agencies from the principal level on down to follow through and implement this rulemaking. Staffs of all six of the agencies have been meeting regularly, and I think there is a commitment to follow through on this.

As you pointed out, the Notice of Proposed Rulemaking (NPRM) has been outstanding since 2016. So given the time that has passed, we will probably have to repropose an NPRM and then follow through with a rulemaking. I think it is realistic to believe we can get an NPRM done this year. I don't know that we can get to the final rule this year, but I believe there is a strong commitment across the six agencies together.

Ms. VELAZQUEZ. Let me just say this: We cannot wait 11 more years and see more bank failures before you actually do something, and I am not kidding. Write the rule.

Chair Gruenberg, on April 3rd, the FDIC issued a press release regarding the upcoming sale of Signature Bank's loan portfolio in New York City, which includes a pool of single-family and multifamily properties. As you know, the FDIC has a statutory obligation to maximize the preservation of affordable housing for low- and moderate-income (LMI) individuals. How is the FDIC working to meet that obligation in this sale?

Mr. GRUENBERG. Thank you for that question, Congresswoman.

This is something I address in my written testimony. And as you may know, the FDIC has been working closely with New York City and New York State, as well as with local community organizations, on the disposition of this very large portfolio of multi-family housing. We are actually meeting with the City and the State on a weekly basis, and regularly with the interested community organizations to ensure a disposition of these properties in a way that will be sustainable and maintain the housing in good condition for the residents and serve well the local communities where those properties are located.

So, this is a key priority for us. We would be glad to follow up with you and work with you on it.

Ms. VELAZQUEZ. Great. It would be a travesty to hard-working families in New York City and other places who are facing an affordable housing crisis to lose on this one.

Vice Chair Barr, I have been investigating the rapid speed at which Silicon Valley Bank grew in size and complexity, and I am considering legislation on this issue. The Fed's report stated a simi-

lar concern. How is the Fed considering reforming its supervisory framework to ensure that if a bank grows in size and complexity, particularly over a short time, heightened regulatory and supervisory standards are applied more quickly?

Mr. BARR. You raise an important point, and we are looking at the tiering framework we have to see whether it should be adjusted, both with respect to regulation and supervision, and part of that is making sure that we don't just focus on asset size as part of that change. We want to look at risk factors such as the one you identified.

Ms. VELAZQUEZ. I yield back. Thank you.

Chairman MCHENRY. The gentleman from Texas, Mr. Sessions, is now recognized for 5 minutes.

Mr. SESSIONS. Mr. Chairman, thank you very much.

And I want to thank our panel of witnesses. This is not your first time to be here. We hope you do well enough to get invited back. We appreciate your feedback.

It is my understanding all four of you were nominated and appointed by the President of the United States. Is that correct?

Mr. GRUENBERG. Yes, sir.

Mr. SESSIONS. Let the record reflect all four were. The organizations which you subscribe to, going up to either the Fed or the Treasury, at the highest level of those two organizations, they described what lay ahead for America as, "transitory." Things were not going to get worse. America was going to go back to work. We were not going to have inflation.

Yet, something happened. Why are you trying to say that supervisors made a mistake when they were listening to, in essence, their boss' boss' boss to say this is not a problem? Transitory inflation and the problems which you are having, why do we now turn around later and act like, well, the supervisors made a mistake not following up with the bank, and the bank made a mistake because even though they were listening to the Fed and to the Treasury Secretary, this isn't going to happen.

Mr. Barr, why are you now holding them responsible when you said, well, one of the four things that happened that were takeaways was that supervisors saw the problem and they did not follow up properly. Who are they supposed to listen to if everybody up and down that line says everything is okay? It is only those darned Republicans or history that say we are wrong, but we are right.

Why are we now dumping on supervisors?

Mr. BARR. Thank you, Mr. Sessions.

The report is looking honestly and frankly at the way in which the bank managed interest rate and liquidity risks and the way that supervisors assessed that. We expect, as part of our supervisory expectations for banks, that they manage their interest rate risk, whether that is in a falling environment or in a rising environment.

Mr. SESSIONS. But the highest level of financial integrity comes from the Fed and the Treasury Secretary. They were arguing against what you just said, this factor. So, is that really why they didn't follow up? Because they said it, but we know that is not going to happen?

At some point, somebody has to accept responsibility that they were misled at the top of your organization. And officially, in front of this Financial Services Committee, we were told repeatedly that it was not going to happen. Everything was okay. You guys were overstating it. And now, you come and blame them.

Mr. BARR. Let me just say the essential facts. I joined the Federal Reserve Board in July 2022, at a time when the Federal Reserve was clearly raising interest rates and had been raising interest rates for some time. This was before my time on the Board, but my understanding was that it was quite clear from the fall of 2021 that interest rates were going to go up. The bank, during this period when the Federal Reserve was already raising interest rates and had said that they were going to continue to raise interest rates, decided to remove its interest rates hedges that protected it from a rising interest rate environment.

So, I think the findings are clear on that point.

Mr. SESSIONS. I remain skeptical, and I know that I have heard the testimony today. Everything is okay. We have gone back and double-checked everything. Nothing bad is going to happen. It is all taken care of.

My point would be, I think somebody needs to accept the blame for the fact that the advice that they were given from the very top of the organization was that it was transitory, and I fail to see that in this report. I fail to see that the advice given from the very top was, in fact, incorrect. And some of the down management decision-making, including the Board's, was they became—they made decisions based upon the top of the deck.

I am not crying over spilled milk. I am crying over the fact that there should have been some history to understand that if you raise spending $3 trillion and then do what has happened out of Treasury, you are going to have a problem.

I want to thank all four of you for being here. And Mr. Chairman, I yield back.

Chairman MCHENRY. The gentleman's time has expired. The gentleman from California, Mr. Sherman, is now recognized for 5 minutes.

Mr. SHERMAN. Mr. Harper, I agree with you. We need parity for credit unions, both as to the level of depositor insurance and as to access to liquidity facilities.

The banks are not doing what we need them to do. We need them to make business loans. We don't need them to buy Treasury bills. Everybody in the world does that. Yet, less than 15 percent of bank investments are in business loans. They are buying marketable securities. They are buying mortgages. We have a good system for financing corporate bonds. We have a good system for financing marketable securities.

A big part of this is our accounting system and the system for regulating banks. Under the Current Expected Credit Losses (CECL) system, we penalize every bank, every time they make a good business loan. On the day they make the loan, profits go down. And under our nonrecognition of an unrealized losses system, for the most part, we tell every bank officer if you invest in marketable securities and they go down in value, it is easy to hide

the loss, and it doesn't count against your income. And you keep your bonus.

And if those marketable securities go up, you can sell them at a profit, increase the profits of the bank, and your bonus goes up. So, why would anybody make business loans when the way to maximize bonuses is to invest in marketable securities?

The Chair, perhaps unfortunately, wanted to say that this is a problem created by Democrats. Yes, we have had inflation recently. Almost all of the spending has been bipartisan due to the COVID crisis. There was one Democratic bill that spent $2 trillion, that was not bipartisan, and there was one Republican tax bill that cut revenues by $2 trillion, that was not bipartisan.

I would say that it is better to have spent $2 trillion helping people in desperate need from COVID effects than to spend $2 trillion subsidizing billionaires. But the big issue here for us is, how do we have a banking system strong enough so that it can survive interest rates going up and interest rates going down? Because you know what? Interest rates go up, and interest rates go down.

And this is not a 100-year event. We had 16-percent interest rates back when I had hair, and we will have 16-percent interest rates hopefully before—or I hope we don't have 16, but interest rates go up, and interest rates go down.

We passed these strong standards with Dodd-Frank. We weakened those standards precisely when the Republican bill weakened the standards for $100-billion to $250-billion institutions, and those are the exact institutions that have this problem. And the regulators actually implemented the law the way it was intended to be implemented, which was to deregulate and nonstress test these medium-sized banks.

Now, we blame them because they did what the Republican Congress told them to do. And particularly pernicious about that bill in 2018 was that it was wrapped in veterans' benefits so as to force or trick, or get some Members into voting for it for that reason. It never went through a real committee process.

Mr. Barr, banks can avoid a good part of the oversight simply by not having a holding company. Should we have a loophole where you can structure your bank differently and choose what level of regulation you are going to have?

Mr. BARR. I think it is important for the system to have an approach where the same risks and the same institutional structures are governed by the same kind of supervision and regulation. In other words, I think not having a holding company as an additional layer of protection so that you can see across all activities of affiliated entities is a concern.

Mr. SHERMAN. We would not have designed our system this way, with so many different regulators, pick your regulator. I wish I could have picked my IRS department when I filed my return. I would have picked the one that would have been less rigorous on me.

I am going to ask the bank regulators, now that we have seen what happened this spring, are we being more vigorous in looking at interest rate risk and are we requiring banks to take prompt corrective action when they face those risks?

Mr. GRUENBERG. I think the answer to that, Congressman, is yes. I think interest rate risk management is probably job one right now, from a supervisory standpoint.

Chairman MCHENRY. The gentleman's time has expired. The panel can respond in writing for the record.

We will now recognize Mr. Posey for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman. Vice Chairman Barr, Barron's estimated that the undeclared loss on Silicon Valley's bonds due to the rapid run-up in interest rates starting in March 2022 would have wiped out nearly all of the bank's $16-billion equity capital base at the year end of 2023. Two of our witnesses at our May 4th hearing said that regulatory capital was not the problem, and that the bank was well-capitalized. Do you agree with that statement?

Mr. BARR. The bank was well-capitalized under a standard that omitted the pass-through of gains and losses on available-for-sale securities. So, I would say that the bank did have solvency issues. The bank was well-capitalized under our existing rules, but those rules permitted them to opt out of the AOCI pass-through. If they had to record that pass-through, the capital impact would have been $2 billion. Because the depositors saw the solvency of the firm as a concern, that is why they ran. So, I do think both solvency and liquidity risks are intertwined in this case.

Mr. POSEY. One of our previous witnesses also said that it is particularly hard to understand why the Federal Reserve failed to regulate interest rate risk when it was the Federal Reserve's monetary policy that created the risk. The Federal Reserve was raising interest rates for nearly a year before the wave of bank distress set in.

Was there a breakdown in communication or strategy between the monetary policy and the supervision weighing at the Federal Reserve?

Mr. BARR. In this case, what the report found is that supervisors identified that there were interest rate problems at the bank. For example, the bank had an interest rate stress model that was not appropriately showing the actual interest rate stress that the firm was experiencing, and called that out to the firm.

So there was not a problem in identifying that risk, but the firm did not take action promptly enough to fix the interest rate issues before it failed. In fact, it ended up doing the opposite, as I mentioned. It took off interest rate risk hedges in March through July of 2022, at a time when rates were rising. That would have helped protect it from some of the risks of those rising interest rates.

Mr. POSEY. What did the Federal Open Market Committee (FOMC) do to identify interest rate risk as a likely outcome of their monetary policy, and to alert the supervisors to remain vigilant?

Mr. BARR. The Federal Reserve was quite attentive to interest rate risks. Really, it is a core part of supervision. Interest rate risk and liquidity risk are kind of bread-and-butter issues in bank supervision. Those were intensified during 2022. As interest rates were rising, supervisors were told and did engage in more aggressive looks at interest rate risk in the banking system. And those efforts, as it turned out with respect to Silicon Valley Bank, did not result in the bank changing its behavior.

As I said, the bank was really undoing some of the protections it actually had and was not taking steps to protect itself from that risk. They were doing the same on the liquidity side. Instead of looking at their liquidity risks, and when they found a problem with their liquidity stress testing, they changed the test to make it less conservative. So, it would seem like the measured risk to the bank was lower when the actual risk was higher.

Those are the kinds of things the bank was engaging in that were really the opposite of what you would want a bank to do when it is facing interest rate and liquidity risk.

Mr. POSEY. Thank you. Did the Federal Open Market Committee (FOMC) issue any communications to bank supervisors related to the likely impending interest rate, and what are some examples if they did?

Mr. BARR. The Federal Reserve made it clear, and the FOMC made it clear really in the fall of 2021, that interest rates were going to need to rise, there would be quantitative tightening going on in terms of shrinking the balance sheet. And as I mentioned, supervisors throughout 2022 were focused on interest rate risk as one of the bread-and-butter issues to address, along with liquidity risk and, as some of my colleagues have mentioned, issues with respect to credit risk, particularly in the commercial real estate space.

Mr. POSEY. Thank you, Mr. Chairman. My time is about to expire, so I yield back.

Chairman MCHENRY. We will now recognize the gentleman from New York, Mr. Meeks, for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman. Chair Gruenberg, in your May 1st report outlining options for deposit insurance reform, I actually was pleased to see that the FDIC favored targeted coverage for business payment accounts. As you said in your written report, "Targeted coverage captures many of the financial stability benefits of expanded coverage while mitigating many of the undesirable consequences."

And one of the things that has been on my mind for some time is whether or not we should bifurcate it or have a tiered system of insurance to create different categories for individuals and small businesses, which we discussed, I think it was the last time that you testified before us.

So, the big question is, because with these businesses, if they cannot pay it is going to damage our economy, what is the appropriate level of deposit insurance for business payment accounts and how would it be paid for? What do you think?

Mr. GRUENBERG. Thank you, Congressman. It is an important question that we need to think through. First, it would require a legislative change to increase deposit insurance coverage for business payment accounts, and as we indicated, as you noted, in our report, of the options available we thought that was the one that perhaps made the most sense because it addresses a potential financial stability risk with these accounts, but the moral hazard is really limited because these accounts are business payment accounts. You cannot utilize them across multiple banks but you really keep them in one institution in order for the operational convenience of the payment account.

I think if the decision is made to increase coverage for this targeted purpose account, it is really a judgment of how high to go, and realizing that the higher the coverage, the higher the assessment costs will be for the industry. I think that is a balancing judgment that would go into the consideration of any legislation that might be needed to do this.

Mr. MEEKS. And I would like at some point later to discuss with you some thoughts that you have on what role the FDIC could play in helping us think through it as Members of Congress.

Let me to go to Vice Chair Barr quickly. You have been steadfast in your remarks that the banking systems remains strong and resilient. While much of the focus has been on the large regional banks, I want to discuss briefly the vibrancy of our community banks, especially what I am passionate about, which is our Minority Depository Institutions (MDIs), and our Community Development Financial Institutions (CDFIs), which play a huge role, as far as I am concerned, in both rural and urban areas.

What I am concerned about is that it is common for the large regional banks to make investments and deposits into the community institutions. In your estimation, will the recent bank failures and associated special assessments have, for lack of a better word, a trickle-down impact on community banks, and should we begin to brace for something happening to community banks as a result?

Mr. BARR. Thank you, Congressman. I share your view that community banks are sound and resilient. They are providing essential services to communities across the country, including the community banks that are CDFIs and MDIs. They are disproportionately responsible for investing in and supporting small business lending and local communities. So, they are just absolutely a vibrant part of our banking system and one that all of us fully support.

The community banks—many Members have said this to me, and you are hearing it in your districts—are doing well in serving their communities but are concerned about the broader ramifications of the economic situation and the banking stress. It is something we are quite attentive to. We want to make sure that we have a diverse range of financial institutions in our economy—small institutions, regional institutions, and large institutions. And we are quite attentive to that in this current environment, making sure that the problems don't affect their ability to lend.

Mr. MEEKS. I have 10 seconds left, and I hoping that you will have a holistic review of the capital framework and take into consideration the ability and willingness of these investments from those larger banks because of these——

Chairman MCHENRY. The gentleman's time has expired. We will now recognize the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman, and I thank the witnesses for being here today.

Mr. Barr, in your own report, you say that the Federal Reserve did not take sufficient steps to ensure that Silicon Valley fixed its problems. You indicated again this morning that the Fed did not take sufficient actions. Just a minute ago, you made the comment to my colleague here, Mr. Posey, that one of the core responsibil-

ities of an examiner is to review interest rate risk and liquidity risk. What happened?

Mr. BARR. Thank you, Congressman. The report found that the interest rate and liquidity risks were identified by supervisors. They called attention to the things like changing the test on——

Mr. LUETKEMEYER. Mr. Barr, it is well-documented in the GAO study that I am referring to here that you continuously monitored the situation and found a number problems with liquidity and interest rate risks. Why didn't you do something? Why didn't your examiners do something about it?

Mr. BARR. I think that is exactly right. What the report found is that risks were identified, but supervisors did not escalate concern about those issues promptly enough and not forcefully enough, and that is one of the reasons why we need to really look internally at our own system of oversight and——

Mr. LUETKEMEYER. I appreciate that comment. I am sure that you guys fired the management team of Silicon Valley when you went in and replaced them, told them to get lost. Has anybody at the Fed lost their job yet as a result of this, since it is a core responsibility of the examiners to do interest rate risk review and liquidity risks, and they did nothing about it?

Mr. BARR. The report found that they acted on it but they did not escalate it sufficiently to change——

Mr. LUETKEMEYER. Is anybody going to lose their job, Mr. Barr, because they were incompetent in doing their job?

Mr. BARR. We are looking across the System at our system of supervision. We want to make sure we have the right personnel in place——

Mr. LUETKEMEYER. So, the answer is no.

Mr. BARR. ——responsible for doing that.

Mr. LUETKEMEYER. Okay. Mr. Gruenberg, in the same GAO report, your agency took a hit as well with regard to Signature Bank. Management failed to take adequate steps to mitigate the bank's longstanding liquidity and management issues before the bank's failure. The FDIC lacked urgency, despite seeing Signature Bank's repeated failures, and when Signature Bank failed to do what you asked them to do, you did nothing. Tell me how this happens?

Mr. GRUENBERG. Congressman, I think that is the core issue here, and to a certain degree is common in both of these. The examiners identified the issues, they provided supervisory guidance and direction. We had an institution here, unlike most banks, quite frankly, that are quite responsive to guidance from supervisors. In the case of this institution, they were not.

I think the core issue was the failure on the part of examiners to compel compliance. When issues were identified, guidance was given, and they were not addressed over a period of time.

Mr. LUETKEMEYER. No, no. Let me interject here. As a former examiner, whenever you see that these two banks were outliers, significantly, for the rest of the banking industry, and you are suddenly going to let them continue to do things that you know are dangerous, not only to themselves but to the system, it is incompetent. You cannot let that continue to go on.

Mr. Gruenberg, is anybody at the FDIC going to lose their job over this?

Mr. GRUENBERG. I think this episode requires us—as you know, our Chief Risk Officer did an internal review in addition to the GAO report. I think it is incumbent on us to do a comprehensive review of our supervision program, including our staffing structure. We are going to have to identify deficiencies and be prepared to——

Mr. LUETKEMEYER. I appreciate that comment. We will see if anything happens. Hopefully, by the next time you come here, we will have some action that would have been taken that would be very prudent.

I appreciate your comment this morning, Mr. Gruenberg, that the industry remains well-capitalized, since there seems to be a discussion about having to raise more capital. I think better supervision would be a better idea than raising more capital.

Mr. Barr, the Federal Reserve has gotten itself underwater in its own situation with this interest rate situation. Chair Powell was here the other day, and he admitted that he is not making any money. He is losing money because his interest rates on his investments are upside down as well. If he is not making any money, how is he paying the bills for the Consumer Financial Protection Bureau (CFPB), because technically, the law says he is supposedly paying it out of revenues? Since there are no revenues to pay it out of, how is he paying the CFPB's bills?

Mr. BARR. The CFPB is being paid in the same way that the rest of the Federal Reserve System is being paid, identically in approach.

Mr. LUETKEMEYER. If that is the case, then they are printing money, because that was the response of Chair Powell. If anyone asked him the question, "How are you paying your bills?", he said, "We are printing more money."

With that, Mr. Chairman, I yield back. Thank you.

Chairman MCHENRY. The gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you very, very much, Mr. Chairman.

Vice Chair Barr, the Fed's recent Financial Stability Report found a number of pressure points emerging in the commercial real estate market, correct?

Mr. BARR. Yes.

Mr. SCOTT. And also, you had a survey that accompanied that report, and commercial real estate was mentioned as, "a possible trigger for systemic risk." Correct?

Mr. BARR. Yes. We are looking quite carefully at commercial real estate risks. Banks are an important part of that market, but they are not the only part. There are lots of non-bank investors as well.

Mr. SCOTT. But I think what we are concerned about is the fact that these commercial risk markets represent only a small part of the total assets held by the larger banked community. However, these mortgages represent one-fifth of total assets held by our nation's smaller banks. That is what we have to be concerned about. And your own staff at the Fed wrote that the rising interest rates over the past year will increase the risk that commercial borrowers will not be able to refinance their loans when the loans reach the end of their term. That is the real story of where we are.

So, my first question to you is, do you believe that smaller and regional banks have a right to be very wary of pressure related to the commercial real estate market?

Mr. BARR. I think it is important for commercial real estate risk to be well-understood and mitigated by banks. Many community banks and smaller regional banks are more concentrated in commercial real estate than the larger banks, so it is important for them to understand their risks and to appropriately mitigate those risks, as institutions are doing.

Mr. SCOTT. It is my understanding, then, that your office has expanded what we refer to as examination procedures for banks with significant exposure to commercial real estate. Would you say this is directly related to the sharp jump in borrowing costs over the past year?

Mr. BARR. The risks in the commercial real estate sector arise from several sources. One of those is that there are much lower vacancy rates in downtown office buildings in many cities because of the response to the pandemic. There are a lot fewer people in office buildings working. That has also put some pressure on retail. We are seeing some pressure in the multi-family space, especially given rising interest rates. And then, rising interest rates make it harder to refinance, and that adds additional pressure.

Mr. SCOTT. My time is expiring, and I have to get your attention focused on this area too, affecting our low- and moderate-income borrowers, especially as we continue to hear about the credit tightening. As you conduct your holistic review of capital and long-term debt requirements, are you fully analyzing the impact this change could have for low- and moderate-income communities and small businesses?

Mr. BARR. We do look at the overall impact of our capital rules, including on low-income communities and on small businesses as part of how we think about the overall effect that capital has. Right now we are seeing, with strong capital in the system, that that is a place that we continue to look.

Mr. SCOTT. And do you anticipate that these new requirements could make it more difficult and costly for those on the margins to get a loan?

Mr. BARR. Our experience is that strong capital requirements make it possible for institutions to serve all their communities through times of stress.

Chairman MCHENRY. The gentleman's time has expired. I now recognize the gentleman from Michigan, Mr. Huizenga, who is also the Chair of our Oversight and Investigations Subcommittee, for 5 minutes.

Mr. HUIZENGA. Thank you, Mr. Chairman. And witnesses, I appreciate it today. I am going to jump right in. Mr. Gruenberg, I would like to start with you. I appreciate the cooperation so far, but I will note that anything you can do to speed up the production of the requested material from the chairman and myself would be much appreciated.

I do want to dig into the bid process that the FDIC uses when they have taken a bank into receivership and look to sell it. In a recent Bloomberg article, Director McKernan was quoted as saying, "The FDIC is hindering the ability of nonbanks to participate in

these auctions because they are not given the same terms as bank bidders with respect to loss share arrangements and deal financing." And I would like to submit that article for the record, Mr. Chairman.

Chairman MCHENRY. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you. Is Director McKernan wrong when he says that non-bank participation is, "really in name only?"

Mr. BARR. We have made a considerable effort for all three of the failed institutions.

Mr. HUIZENGA. So, you believe he is wrong?

Mr. BARR. I may just answer to say that I think we have made a significant effort to invite both bank and non-bank interested parties to participate in the bidding process, and they have.

Mr. HUIZENGA. Okay. Vice Chair Barr, last week one of your colleagues, Governor Bowman, called for a third-party review of the actions of the Fed in connection with Silicon Valley Bank's failure. Will you commit to facilitating a third-party review of the Fed's actions?

Mr. BARR. I thought it was important for us to start with a self-assessment. Obviously, the Congress is looking at these issues. The Inspector General is looking at these issues. The GAO is looking at these issues.

Mr. HUIZENGA. So, do we count as a third party?

Mr. BARR. I do not know what Governor Bowman meant by that, but to me, you are not part of the Federal Reserve.

Mr. HUIZENGA. Okay. Do you believe there needs to be a third-party, independent review outside of the congressional review and your own internal review?

Mr. BARR. I think there are such reviews going on already.

Mr. HUIZENGA. Will you commit to providing the committee with full access to the documents and employees needed to conduct our own assessment?

Mr. BARR. We have been cooperating with your staff on that, and we will continue to do so.

Mr. HUIZENGA. I think I will echo what I told Mr. Gruenberg: Anything you can do to speed that up would be much appreciated. As the Chair had quoted about this culture shift, he had noted that you included that prominently in your report. Did you hear about these, "culture shift," concerns prior to conducting your internal review, or was that news to you until the review?

Mr. BARR. I had heard similar reports before the staff conducted this review.

Mr. HUIZENGA. Okay. GAO testified before my Oversight and Investigations Subcommittee last week about their own review of the bank failures, and in response to a question, the GAO witness stated that, "no such culture shift," was raised in their own interviews with the Fed staff. So, why are you keeping it a secret? If it is that big of a concern, why is it a secret that you are not telling the GAO about? And, in fact, the GAO's testimony confirmed that a slow escalation of supervisory concerns has been noted in their reports since 1991.

Here is what I would like to ask you. You said there were about 20 individuals who were interviewed for your internal report. Will

you provide the committee with a list of those employees whom you interviewed for the report?

Mr. BARR. The 20 I was mentioning in my testimony are the people who are conducting the review.

Mr. HUIZENGA. Okay. How many interviews were done for that report?

Mr. BARR. I would be happy to continue to work with your staff, and have our staff work with them on all of the requests that you have made. That is part of our ongoing operation.

Mr. HUIZENGA. Okay. Is that a yes, you will commit to allowing us to identify the staff and then allowing us to speak to them?

Mr. BARR. I think that there are some tradeoffs involved in that, that I would like our staff to discuss with your staff.

Mr. HUIZENGA. What tradeoffs? You are telling me that you are not sure whether there should be an independent, third-party review, that we are not part of the Fed so we should be doing a review. We are trying to do the review, but you are telling us we may not be able to talk to the people who might actually have the information that would be helpful to the review.

Mr. BARR. As the chairman of the subcommittee, you are, of course, welcome, in the end, to decide to whom you want to talk and get cooperation from them.

Mr. HUIZENGA. We are getting closer. Okay.

Mr. BARR. I am just pointing out that there is a tradeoff in terms of making sure that in the future, when we do reviews, we have staff who are——

Mr. HUIZENGA. I have one last thing. Just as we, and you, I would assume, expect management failures to be owned up to by the management, do you take full responsibility for supervisory failures at the Fed under your watch?

Mr. BARR. Yes, I do.

Mr. HUIZENGA. Okay. A lack of enforcement on your part does not mean a need for more regulation.

Chairman MCHENRY. The gentleman's time has expired.

Mr. HUIZENGA. It means stronger follow-through by the regulators.

Chairman MCHENRY. I will now recognize Mr. Lynch of Massachusetts for 5 minutes.

Mr. LYNCH. I thank the Chair. Chair Gruenberg, I just want to start off by saying thank you on behalf of the people of Brockton, Massachusetts, for your willingness to come to Brockton and to listen to their concerns about the failure of Silicon Valley Bank and the impact that it could potentially have on the creation of affordable housing in that City. I can say that my constituents asked me to say thank you to you publicly, and your staff, for your willingness to come to Brockton.

Mr. Barr, every bank in American had to deal with rising interest rates, but Silicon Valley Bank was doing something very, very different. They concentrated on startups, venture capital-funded startups. And early-stage startups are probably more prone to failure and volatility than mature businesses. SVB also did deposits, because they went after these companies. Their deposits went from $60 billion to $180 billion in 2 years, so very fast growth there.

The thing that puzzles me is that they bought $91 billion in T-bills at a time when the interest on T-bills was very, very low, and they were long duration. Did that contribute—well, let me fast forward. When Chair Powell announced, for months and months and months, that he was going to increase interest rates and then began to do so, that $91 billion at Silicon Valley Bank, the value of those T-bills and Treasuries plummeted to $21 billion, and that is when people started to pull their money out.

What was the responsibility of the Fed in light of the unwise decision on the part of the management of Silicon Valley Bank to operate in that way?

Mr. BARR. The Federal Reserve supervisors looked at these issues and found that the bank had been mismanaging its interest rate risk and its liquidity risk. It had removed hedges that would have protected it from a rising interest rate environment. It had changed its interest rate sensitivity test in order to make it less conservative. It changed its liquidity test to make it less conservative. It failed to fully understand the risk from its concentrated depositor base or the risk associated with the venture capital fund deposits.

The supervisors pointed those out, but the bank failed to correct those issues. So, as I said, it was fundamental interest rate and liquidity risk mismanagement on the part of the bank. Where we fell down on the job was not forcing them to make those changes fast enough, and that is outlined in the report.

Mr. LYNCH. So that was the point of failure, really, where they got themselves into trouble and somebody did not compel them to change their—I am not even sure at that point, where they had lost so much money, I am not sure what you could have done. But what are the tools that you might have availed yourself of, if you had them, to prevent a total meltdown like we saw?

Mr. BARR. One example I will cite for you is that generally speaking at the Federal Reserve, we do not put in place immediately mitigants or incentives on a firm, so higher capital, for example, or higher liquidity, or limits on incentive compensation, or limits on capital distributions. And those kinds of tools might be appropriate in some cases where you have a firm that is not responding fast enough to significant issues at their bank. That might have made a difference here.

And obviously, we are also looking more broadly and structurally—this firm grew very rapidly at a time when it was subject to much lower regulatory and supervisory standards. If we had had in place those higher standards, the firm might have had more significant risk management infrastructure in place, and stronger capital and liquidity in place. So, we are really looking across the board at both supervision and regulation to see where we might make improvements.

Mr. LYNCH. Okay. Mr. Chairman, my time has expired. I yield back. Thank you.

Chairman MCHENRY. The gentleman has time to yield back. I thank the gentleman.

We will now recognize the gentlelady from Missouri, Mrs. Wagner, who is also the Chair of our Capital Markets Subcommittee, for 5 minutes.

Mrs. WAGNER. Thank you, Mr. Chairman.

Vice Chair Barr, when you testified before this committee in March, I asked you why the Fed had not considered escalating any of the supervisory concerns at SVB into more formal enforcement actions. Your response was that you would be looking into it. It has now been 2 months since these failures occurred and your report has been released.

So, I will ask the question again. After dozens of supervisory determinations were issued, over many years, that went unanswered by SVB's management, what prevented the Fed from escalating its supervisory actions against the bank, and why didn't the Fed recommend any formal enforcement actions against the bank?

Mr. BARR. That is detailed in our report. It is 114 pages, basically, laying out the problem that you explicitly asked about and that was addressed in our last hearing. And what we found is that supervisors were essentially too timid and too slow to raise those standards in a timely enough way.

Mrs. WAGNER. It was years. These citations, these supervisory determinations were handed out over years. Where is the management? Where is the supervision of the regulators?

Mr. BARR. Some of those issues that were identified many years ago, the bank responded to, and those issues were closed. But new issues were opened, and the bank was not timely in responding to those. So, it is a problem of getting our supervisory teams to be acting with more agility.

Mrs. WAGNER. I hope there are going to be repercussions for this, because this has obviously now escalated into a much broader concern. Do you agree that escalating supervisory actions should have happened sooner, sir?

Mr. BARR. Yes. That is consistent with the report's findings.

Mrs. WAGNER. Thank you. Based on the Fed's report and the GAO's independent review of agency actions, there is just a decades-long, slow-to-act pattern that we are seeing when it comes to enforcement. It is clear that these failures could have been prevented if our regulators acted more forcefully with bank management to mitigate risk.

I raised three children, and when I told them to stop doing something and they kept doing it, I did not take them out for ice cream, sir. I put them in time-out. These banks needed to have been supervised more closely, and action needed to be taken.

Vice Chair Barr, in your SVB report you stated that, "SVB failed because of a textbook case of mismanagement by the bank and that Federal Reserve supervisors failed to take forceful enough action." You also stated that, "Our banking system is sound and resilient, with strong capital and liquidity." Yet, instead of addressing the identified failures in a timely fashion, you somehow concluded that you need to bolster financial resiliency by layering on more regulations, specifically, capital requirements, but the implementation of the Basel III Endgame rules.

Shouldn't your first priority, sir, be ensuring that existing prudential regulations are effectively enforced before layering on more regulations? If bank regulators, supervisors, and examiners do not properly enforce existing rules, putting more rules in place does not fix anything.

Mr. BARR. I think that we need to do both. I think we need to enhance our system of supervision to make it more agile, and more quick. We need to also improve our system of regulation so that we have the kind of resiliency we need, with capital and liquidity in the system. We have been working together, the other regulators and I, on a Basel III Endgame package since I arrived at the Board in July of 2022, and——

Mrs. WAGNER. It has been going on for years, decades. What I am trying to get at is you have to effectively enforce the rules and regulations that are on the books now, before layering on more onerous capital requirements and regulations.

What analyses have you done to demonstrate that had the Basel III Endgame rules been in place, the SVB failure would have been avoided? And will you provide those to the committee?

Mr. BARR. What we are looking at in the Basel III Endgame rule is capital resiliency for the very-largest firms as a whole. We are not trying to target it to SVB.

Chairman MCHENRY. The gentlelady's time has expired.

We will now recognize the gentleman from Missouri, Mr. Cleaver, for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman. I want to direct my conversation to Mr. Hsu, and to Mr. Harper, and it will not surprise you where I am going. In 1977, your agencies did something that I think we might not be able to have happen now, and that is to create the Community Reinvestment Act (CRA). A lot of people think Congress created it. Congress has amended it, but Congress did not create it. And over the past few years, we have had amendments from time to time. We have not had anything since, I think, about 1995. And I know all of the agencies have been working over the past few months, because I have been chatting with all of you and others about CRA.

One of the things that I am concerned about is that Gramm-Leach-Bliley made, I think, some corrections so that the smaller banks would have fewer examinations for CRA exams. I have a bill, the Community Reinvestment Reform Act, that would subject independent mortgage companies to CRA exams, codify community benefit agreements, specify endowments, and create an improvement plan, and require disclosure of deposits from low- to moderate-income communities.

Is that one of the changes that you think would be compatible with the direction you are going?

Mr. HSU. Representative Cleaver, thank you for that question. Anything that can be done to strengthen and modernize the CRA would be welcome. I think that is something that we are all committed to, so I would be happy to engage with your staff on the proposal that you just discussed.

Mr. CLEAVER. Mr. Harper?

Mr. HARPER. CRA does not apply currently to credit unions, although some States have applied CRA to State-chartered credit unions.

Mr. CLEAVER. So, you do not think we could do that? I guess the last thing I want to do is get involved with credit unions. I have been around for a while, and that is a headache I cannot just ignore, put it out of the way.

CDFIs and MDIs, which serve small businesses and communities, are feeling the pinch of tighter credit standards, and they are also feeling the pinch of their own with investors and larger banks pulling back on lending. Does this trend signal that we need a stronger incentive, such as through the Community Reinvestment Act, so that banks are encouraged to make investments in those communities' financial institutions?

Mr. HSU. I will start, and I think my colleagues will be happy to jump in. Yes, having strong MDIs and CDFIs is an important objective. I think we all agree on that. Within the proposal, the joint proposal for the CRA that was put out by the OCC, the FDIC, and the Fed, under the proposal, it was to improve the speed and to make it easier for banks to invest in and support CDFIs and MDIs. We are in the process of finalizing that, so I cannot get ahead of our finalization. But that is an objective, and we got a lot of comments on that from the public and we will be incorporating that as we make that finalization.

Mr. CLEAVER. You used the word, "comments." I know you went through the comment period. And I am sure that all of the big banks were very kind and cooperative in their comments to your work. Am I wrong?

Mr. HSU. I think there were a range of reactions, and we are taking all of those into account as we finalize the rule.

Mr. CLEAVER. I yield back, Mr. Chairman.

Chairman MCHENRY. The gentleman yields back.

I will now recognize the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR OF KENTUCKY. Thank you. Vice Chairman Barr, the independent GAO report concluded that the Federal Reserve identified risks and took supervisory actions but did not adequately escalate actions prior to SVB's failure. Do you agree with that conclusion?

Mr. BARR. Yes. That is the same conclusion we reached in our own report.

Mr. BARR OF KENTUCKY. Yes, you did, and I appreciate that, and I have your report here. On page 8 of that report, you pointed out that SVB moved from the regional bank portfolio to the large bank portfolio in February of 2021, approximately 2 years before Silicon Valley Bank failed. You also noted on the same page of your report that the Fed Board provided the Federal Reserve of San Francisco team, the supervisors here, a waiver to delay the initial set of ratings under the large financial institution rating system by 6 months, to August 2022.

I think the reason why both reports conclude that the Fed failed to adequately escalate is because the Fed itself is delaying implementation of the enhanced supervisory standards. So, I don't think this is a failure of regulation. I think both reports are acknowledging that it is not regulation, that the bank was subject to enhanced regulation 2 years before the bank failed.

I do want to revisit the issue of the policy recommendations of more regulations, but I also want to ask why the report, your report, says nothing that I can see about monetary policy mistakes? Do you acknowledge that the Fed was wrong, in 2021, to conclude that rapidly-rising inflation was transitory?

Mr. BARR. The report is focused on the supervisory failings and the Federal Reserve's——

Mr. BARR OF KENTUCKY. Sure. I know that.

Mr. BARR. ——and the staff is not——

Mr. BARR OF KENTUCKY. No, no, no. I know that. But do you acknowledge that the Fed should have started to normalize monetary policy and raise interest rates earlier, in light of excess fiscal stimulus and persistently-high inflation?

Mr. BARR. I was not on the Federal Reserve Board at the time.

Mr. BARR OF KENTUCKY. I know you weren't. But I want to know why the report doesn't talk about this. The divorcing of monetary policy from supervision is a problem. Do you acknowledge that interest rate management would be easier and supervision of these institutions would have been easier had monetary policy tightening started earlier, and had been implemented gradually as opposed to precipitously?

Mr. BARR. The responsibility of bank management is to take the monetary policy, the interest rate world around it, and to respond with appropriate risk metrics, and they didn't do that.

Mr. BARR OF KENTUCKY. I understand that. But here is the problem. The argument for why regulation and monetary policy are both at the Fed is that it is supposed to inform each other. Supervisory policy should inform monetary policy. And the reason why the Fed has always argued that they should retain their supervisory authority is because it informs monetary policy. They are intertwined. And the failure of the Fed to acknowledge that monetary policy errors are the underlying cause of bank instability is very revealing.

Let me quickly ask you on capital review, two scenarios, Vice Chair Barr. Bank One has 94-percent uninsured deposits. It reports $91 billion held-to-maturity securities with a market value of $76 billion, and an unrecognized loss of $15 million. Its cash-out at the Fed represents approximately 5 percent of its uninsured deposits, and a single industry represents more than 50 percent of the institution's customer base. That is institution one.

Bank number two has just 14 percent of its deposits uninsured. It holds zero held-to-maturity securities, approximately 93 percent of its liquidity is in cash held at the Fed, and that cash represents more than 100 percent of its uninsured deposits. The bank has a large and diverse customer base with tens of millions of individual and small business customers.

Do you understand the differences between the banks I have just described?

Mr. BARR. I think in general terms, although, of course, I was not following your math with precision.

Mr. BARR OF KENTUCKY. You generally understand the vast difference between those institutions, but they are the same size, the exact same size. Do you believe these two institutions should be subject to an identical bank capital regime?

Mr. BARR. I think our capital regime and our liquidity regime should take account of the risk profile of the firm.

Mr. BARR OF KENTUCKY. That is good, because the Basel Committee on Banking Supervision does not. So my question to you is,

will you commit to deviating from the Basel recommendation that fails to tailor the capital charges for operational risk?

Mr. BARR. I would be happy to follow up with you to discuss your concerns in greater detail.

Mr. BARR OF KENTUCKY. I would like to do that, because operational risk differences should inform bank capital regulatory changes.

Chairman MCHENRY. The gentleman's time has expired.

The gentleman from Illinois, Mr. Foster, is recognized.

Mr. FOSTER. Thank you.

Acting Comptroller Hsu, you emphasized the importance of regulatory discretion in your remarks, which is a lot of what we are wrestling with right here. And there is obviously a fine line between regulatory discretion and regulatory capture, which is one of the risks. And discretion, we are learning, again, can also be very dangerous if banks come to rely on discretion instead of actually solving the problem. So, are there instances that you can think of where less discretion might actually be a benefit that would provide more leverage in your negotiation with a bank that is not really complying?

Mr. HSU. Thank you for the question. Ultimately, what we want and what we need is a safe and sound and fair banking system. That is the goal. The way to achieve that is through a balance of regulation and supervision, in equal parts. The regulations provide clear rules of the road, clear speed limits, so to speak. Supervision, really strong supervision entails the exercise of that discretion, to know when to call out particular issues, to identify risks, to escalate them, and to act. And I think that is what a lot of the conversation has been about today. So, we have to do both in equal parts.

Mr. FOSTER. For example, if there was a rule that you had mandatory escalation whenever a bank was approaching mark-to-market insolvency due to interest rates, instead of the way we have been not handling that, would that have been an advantage in these banks' situations?

Mr. HSU. Mechanisms like that can help. I think it really depends on the context of the issues. But that is something that we think about internally for different types of issues within our internal policies and procedures, what fits within a particular mechanism of automatic escalation versus that which requires some judgment. It depends.

Mr. FOSTER. Any other comments on this from any of the other witnesses?

Mr. GRUENBERG. Congressman, the issue you described is a constant tension, I think, in the supervisory process. I have had meetings with bankers and I had one banker say, "There needs to be consistency across supervisors." And I had another banker say, "Supervisors have to be able to exercise judgment in looking at my institution." And they would both be in agreement at the same time, that the comments suggest attention, and I think that is something you sort of have to work through in the supervisory process. You obviously want consistency, but you want examiners, based on their experience, to be able to exercise judgment as well.

And I think that is part of the challenge of thoughtful supervision, quite frankly.

Mr. FOSTER. Yes.

Mr. BARR. I would just add to the conversation that I do think we need to make it clear to supervisors that they have all the tools they need to use that discretion in the appropriate place. I mentioned the example that we generally do not use supervisory tools that we could use—limits on incentive compensation, limits on capital distributions, requiring additional capital, requiring additional liquidity—even when we see a serious issue. And we could flip the presumption——

Mr. FOSTER. So, why do you decide not to do that?

Mr. BARR. ——so that those tools are more readily available to supervisors, but that is not——

Mr. FOSTER. By default, for capital distributions and bonuses or whatever, would not be allowable if you are in violation of hard and fast requirements.

Mr. BARR. That could be an approach that provides the appropriate toolbox——

Mr. FOSTER. It might get the attention of the bank board and the CEOs in ways that seem to have failed here.

Vice Chair Barr, could you say a little bit about the timeline you anticipate for the holistic capital review, any rule changes that might come out of this episode, and so on? How does that look? When can Congress expect to see some presentations? When can we expect preliminary and final rulemakings on all of these?

Mr. BARR. Thank you. I expect this summer that we will be able to present my thinking on this, and that the three agencies working together will be able to come forward with a Basel III Endgame proposal for public comment.

As I have said before, any changes here would go through the normal rulemaking, so there would be a proposal, get public comment, and then a final rule, and then a transition period for banks to come into compliance.

Mr. FOSTER. And I hope there would be a role for Congress in that, in particular early on, when you have concluded the direction you want to go for these, to actually have a discussion with Congress and allow industry time to react before things are fully baked, because this is not purely a safety and soundness thing, as I mentioned in my opening remarks.

Thank you, and I yield back.

Chairman MCHENRY. The gentleman yields back. The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. I thank the chairman. And I thank the folks who comprise the majority of our bank regulatory framework for being here today and for the attention you are giving, particularly in the wake of the failures that we are talking about today, to make sure that we do have a safe and sound system, and frankly not just to write reports about it but to actually do stuff. I think my takeaway from the report that you authored, Vice Chairman Barr, was that it wasn't really a failure of the regulation itself, it was a failure of the regulators to actually take action on what they may have observed.

And when I look at Silicon Valley Bank, in particular, what really triggered it was a run on the bank. And my question is, what triggered the run on the bank? Did you look into the wires out? Who was moving the money? How many individuals or entities were actually moving the money in the weeks leading up to the run?

Mr. BARR. Thank you for the question. The fundamental issue at the bank before there was a run was that they mismanaged their interest rate and liquidity risk.

Mr. DAVIDSON. I understand that. I do not know any individuals who managed their interest rate risk worse than Silicon Valley Bank. But my question is, what led to the run on the bank? Who was moving the money out?

Mr. BARR. Obviously, for privacy reasons, we don't generally look at transaction accounts of individual customers. We can see the dollar flows. The dollar flows were enormous. Thursday afternoon: $42 billion in withdrawals. Lined up the next morning: another $100 billion in withdrawals. And that was over 80 percent of the deposits in the bank.

Mr. DAVIDSON. I think it is important when we look at the other part of our capital markets, that this bank was shorted. This was a publicly-traded bank. There were a lot of shorts in the bank. We are looking right now at a lot of pressure on our committee to try to say, oh, you guys have to ban short selling. Well, no, we don't. There are some issues with naked shorts and people actually having custody of the shares, and more shares being lent than are actually available. There are some things that are still unaddressed post-GameStop on the shorting of publicly-traded companies.

But the problem here is who led the short, and is that in any way correlated to the people who were moving the money out. We have asked for that data and we haven't gotten it, and we can look at it in the most confidential setting. I respect the fact that we shouldn't publish it online for everyone to see. But someone is looking into this, correct?

Mr. BARR. I don't actually have access to individual transaction-level data. The SEC is responsible, obviously, for market integrity issues, so that is a question that should be directed to them.

Mr. DAVIDSON. Okay. So if the Fed doesn't, does the OCC have access to this data?

Mr. HSU. For the short-selling data, no.

Mr. DAVIDSON. No, no. Not short sellers. I know you are not a securities regulator. You are a banking regulator. Who moved the money? Was it one person? Was it 2,000 people? How many different entities and individuals were behind what caused the cascade effect? It built momentum.

Mr. HSU. SVB was not an OCC-regulated bank, so I can't answer that question.

Mr. DAVIDSON. Okay. So if you look down at the State regulators, the State regulator would have these records, right?

Mr. BARR. I do not believe so, sir, no.

Mr. DAVIDSON. So, you think this will be an unsolved mystery?

Mr. BARR. As I said, the SEC has jurisdiction over market integrity issues. It is really——

Mr. DAVIDSON. We are not talking about market integrity. We are talking about a bank run, which you guys are supposed to make sure doesn't happen. Does the FDIC have transaction data?

Mr. GRUENBERG. I would want to check on that, Congressman, and get back to you. We may have some ability to look. The issue is deposit withdrawals and who was responsible for the largest deposit withdrawals that may have contributed to a particular bank failure. That is something we could——

Mr. DAVIDSON. If you look strategically, the risk of a major run on a bank is something to which we should pay a lot of attention. How would this be engineered? There could be a malicious intent behind a bank run. There could be a coordinated effort behind multiple entities to cause bank runs. And that would be a real problem. Would that be a problem if that were to happen, Vice Chairman Barr?

Mr. BARR. Depending on the facts and circumstances, it could be, if there was——

Mr. DAVIDSON. I think the answer is simple, yes, it would be. Does anyone object and think it would not be a problem?

I just think when you look at market risk, the other thing, there are a lot of people pushing for more government. It seems like in every kind of situation, the solution is more government.

As most of you probably know, almost half of privately-insured credit unions are in my State of Ohio, a very big presence for credit unions in Ohio. Do you have any plans to give them access to the Bank Term Funding Program?

Mr. BARR. I see my time has expired. May I answer?

Chairman MCHENRY. Time enough to answer that.

Mr. DAVIDSON. A yes or no would be——

Chairman MCHENRY. A yes or no would be respectful to the committee in a bare minimum way.

Mr. BARR. The Bank Term Funding Program was set up immediately in response to the——

Mr. DAVIDSON. I understand the history. It is really yes or no.

Mr. BARR. We don't currently have plans——

Mr. DAVIDSON. Okay.

Chairman MCHENRY. The gentleman's time has expired.

Mr. DAVIDSON. Yes or no. Okay, thank you.

Chairman MCHENRY. Let me just ask the panel to try to answer the questions. I think Members appreciate that and get less aggravated, on a bipartisan basis. It also makes it go quicker for all of us. Thanks.

With that, I will now recognize the gentlelady from Ohio, again Ohio, Mrs. Beatty, for 5 minutes

Mrs. BEATTY. Thank you, Mr. Chairman, and thank you to the witnesses.

Let me start by saying, earlier one of my colleagues wanted to point out you were appointed by President Biden. Mr. Gruenberg, is the name, Jelena McWilliams, familiar to you, and who is she?

Mr. GRUENBERG. She was the former Chair of the FDIC.

Mrs. BEATTY. And was appointed by——

Mr. GRUENBERG. President Trump, I believe.

Mrs. BEATTY. Okay. And I could probably go down the list and do the same thing with you, with the National Credit Union Asso-

ciation. Does the name, Rodney Hood, mean anything to you, Mr. Harper?

Mr. HARPER. Yes. He is currently a board member on the NCUA board and was previously chairman.

Mrs. BEATTY. And he was appointed by——

Mr. HARPER. President Trump at the time.

Mrs. BEATTY. Thank you. Also, Dodd-Frank was mentioned earlier. Let me remind you, as I recall Dodd-Frank, if we go back more recently, it was President Trump who signed the law to roll back some of those critical parts of Dodd-Frank. And many believe had that rollback not happened, of rolling back the stricter oversight, since we are talking about oversight today, maybe SVB and Signature would not have released those stronger rules and oversight, which would have made them subject to stronger liquidity and capital requirements, maybe just to withstand some of the financial shocks they took. And they would have been required to have regular stress tests to expose them to their weaknesses. That was just a statement and not a question for you all.

Now, let me ask you, Mr. Gruenberg, I have been very interested in the deposit insurance reform in the wake of the recent bank failures. Back in March, you will probably recall that right after the SVB collapse, I asked all of the witnesses at that time, of the three reform options, which they thought were best. Now, let me fast-forward to last week when I asked that same question of all of our witnesses, and they all said, "targeted approach," whether they were a Democrat witness or a Republican witness. Would it make sense, do you believe, to focus on small businesses with that kind of approach?

Mr. GRUENBERG. Yes, and that is what we suggested in the report that we released, Congresswoman.

Mrs. BEATTY. Okay. Thank you. Mr. Harper, knowing that credit unions have a deposit insurance scheme, I would like you to weigh in on the discussion about deposit insurance reforms. What were your recent reactions to that FDIC report, and did any particular option resonate with you, in particular?

Mr. HARPER. First, if there are changes made in the Deposit Insurance Fund, which the FDIC administers, we believe that there should be parallel changes made for parity in the Share Insurance Fund that the Credit Union Administration manages.

Of the options presented, certainly, the targeted option was the better option and there can be some real policy reasons behind why you might want to do that. I will also note that our small business accounts tend to be very small.

We recently did a survey, and typically, they are between $7,000 and $15,000 at our largest credit unions where we have checked that data. But there are certainly some accounts where they are much higher.

Mrs. BEATTY. Okay. Thank you. Let me continue with you. Just last month, we opened a new Black-owned MDI in Columbus, and the first in the great State of Ohio. And while I was proud of the achievement, the fact still remains that there are only 19 Black-owned MDIs in the United States, and that is a 43-percent decline just since 2001, and over the past 10 years, we have seen a number of MDIs decline by 20 percent.

Is there anything you can tell me that you are doing to help preserve MDIs?

Mr. HARPER. First, I think when you said 19 MDIs, I think that is—

Mrs. BEATTY. 19 Black-owned MDIs.

Mr. HARPER. Black-owned MDIs, but that is on the bank side. On the credit union side, we have in total 503 MDIs, and I believe nearly 300 of them are actually Black-owned. So, it is a sizable portion of our MDI marketplace.

One of the things we did most recently was to change our examination procedures. We have to recognize that there is a different business model that MDIs have in working with the community, and sometimes that means that there are higher expenses.

They shouldn't necessarily be penalized in their exam reports by being compared to non-MDI peer metrics. So, we have done that. Also, thanks to Congress, we are now——

Mrs. BEATTY. I think my time is up, but we can continue this later. And let me just say thank you to all of the witnesses for being here, and also for making appointments to see me. Thank you.

Chairman MCHENRY. The gentleman from Tennessee, Mr. Rose, is recognized for 5 minutes.

Mr. ROSE. Thank you, Chairman McHenry, and thanks to Ranking Member Waters, and thank you to our august guests for being with us today.

Acting Comptroller Hsu, last year Senator Elizabeth Warren sent you a letter urging you to block the TD Bank-First Horizon deal, and reports suggest the deal fell apart 2 weeks ago because the 2 banks were not given a timetable for regulatory approvals. First Horizon stock is down 50 percent since the failed merger with TD Bank. As I am sure you are aware, markets can handle good news, and markets can handle bad news. But what markets can't handle is inconsistency.

So, Acting Director Hsu, what impact did Senator Warren's letter have on your decision to slow-walk this merger?

Mr. HSU. Thank you for the question.

On every merger application, we follow the law. We follow our guidelines. We follow our policies and procedures. We have the Bank Merger Act. There are a list of statutory factors that a merger must—we have to consider the impacts on competition, on the convenience needs of the community, on financial stability, on the financial and managerial resources of the entity, on Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance.

We have to take all those into account for statutory purposes. Under our guidelines, the Comptroller's Licensing Handbook, which is public, we list out the framework we apply to evaluate those and we do that in every single case.

Mr. ROSE. I am wondering, you testified that the OCC is committed to being open-minded when considering merger proposals and to acting in a timely manner on applications. What about the OCC's actions during the TD Bank-First Horizon merger was timely?

Mr. HSU. Every case is different. We have to evaluate each case on its merits and we do so applying those standards equally. But

as I said, I can't speak to individual transactions. What I can say is that different transactions have different features, and some of them can be dealt with more quickly than others.

Mr. ROSE. How long should banks expect it to take for the OCC to typically approve a merger? Is it 6 months? Is it 12 months? Is it 24 months?

U.S. Bank and Union Bank, and Bank of Montreal and Bank of the West, each waited over a year for their mergers to be approved, and TD Bank and First Horizon waited over a year without an answer.

There is an old saying in the law that justice delayed is justice denied. Do you have enough staff at the OCC to review these things in a timely manner?

Mr. HSU. We do have enough staff. The closer that a merger hews to the statutory factors I just listed out, the faster that approval will go. I think this does highlight that the frameworks that we use to apply the statutory factors are old. They have been around since 1995.

We have been working across the agencies, not just the OCC but with the Fed, the FDIC, and with the DOJ to try to update those to current times. That is a project we are working on because we want to make sure that is updated and modernized for today's environment.

Mr. ROSE. I must say I am skeptical about the timeline, and I wonder, how do you balance the need to promote competition in the banking industry with the need to allow banks to grow and innovate?

Mr. HSU. Again, we take each case on its own merits. We evaluate those against the statutory factors and against our guidelines. It is hard to generalize because each one of these cases is a little bit different.

Mr. ROSE. Chairman Gruenberg, as part of the deal to acquire First Republic, the FDIC provided JPMorgan with a $50-billion note. I know you are familiar with that. What was the interest rate agreed to on that note?

Mr. GRUENBERG. I think it was 3-some percent. I would have to double-check that, Congressman.

Mr. ROSE. So is that the going market rate for a loan of that size?

Mr. GRUENBERG. I believe it was the market rate but I can double-check that for you as well.

Mr. ROSE. Do you believe that financing at this rate satisfies the FDIC's obligation to resolve banks in a way that is least costly to the Deposit Insurance Fund?

Mr. GRUENBERG. In this case, yes, Congressman. We had a number of bids. The bid from JPMorgan was the least costly, and these were the terms we were able to negotiate.

Mr. ROSE. Vice Chair Barr, in your view, would the interest rate risk that led to large mark-to-market losses on SVB's assets have occurred without the high inflation that the United States has experienced since April of 2021, and the rapid rate increases engineered by the Federal Reserve to address runaway inflation?

Mr. BARR. The interest rate risk that it faced in the particular moment was related to the rapidly rising rates, yes.

Mr. ROSE. Thank you. I yield back.

Chairman MCHENRY. The gentleman's time has expired.

I will now recognize the gentleman from Illinois, Mr. Casten, for 5 minutes.

Mr. CASTEN. Thank you, Mr. Chairman.

Mr. Barr, as we have been in this hearing, the former CEO of SVB, Mr. Becker, has released his written statement for our upcoming hearing. In that statement, he indicates that in April of 2022, he led the effort to fire their chief risk officer, Laura Izurieta, in part based on feedback from regulators. I am just wondering if you can confirm that regulators did raise specific concerns with Ms. Izurieta, and whether that had an mpact on her termination.

Mr. BARR. My understanding is that supervisors concurred in the judgment of the CEO that the CRO was not up to the job.

Mr. CASTEN. Okay. SVB did not publicly disclose that they were without a risk officer until almost a year later. Were the supervisors aware that that information was not made publicly available?

Mr. BARR. I don't know the answer to that question. Generally speaking, bank supervisors are not in charge of providing advice to banks about disclosable or nondisclosable events. That is handled by the bank as part of its obligations under the securities laws.

Mr. CASTEN. Okay. But presumably, you would appreciate that risks to equity risk and risks to deposit risk all get intermingled in the mind of the CEO. During that period between when their risk officer was fired and they disclosed to the public they didn't have a risk officer, they sold off $2 billion of interest rate hedges.

Were you aware that they had sold that off? Were you in any way consulted, you or your office consulted in, essentially, the deinsurancification of their interest rate exposure?

Mr. BARR. I arrived at the Federal Reserve Board in July of 2022. I was not aware of any of the particular matters with respect to SVB until an information report in February of this year.

Mr. CASTEN. Does anybody else want to comment? I want to understand. They didn't have a risk officer. We knew they didn't have a risk officer. We knew that they hadn't disclosed to the public that they didn't have a risk officer, and that they were selling off interest rate hedges. Were the supervisors who had a role in getting the risk officer terminated aware of that change in their hedging strategy?

Mr. BARR. The supervisors became aware of the removal of those interest rate hedges. I don't know precisely at what moment they became aware of that, and they recognized that as a risk that the firm had incurred.

Mr. CASTEN. Okay. I really do appreciate your candor here, particularly in the report that you sent before. I think it is appropriate to sort of acknowledge where we had some failures. We will be judged not by what we did in hindsight but what we do, going forward.

As of right now, the spread between the ask yield on Treasuries with a due date of May 31st and June 15th is a hundred basis points and, of course, the credit to swap default swaps on U.S. Treasuries are priced about 8 times as high as they were a few months ago.

Given what we have just learned about banks, SVB in particular, not maintaining a robust hedging strategy, are you monitoring the changes in interest rate hedging among the banks you supervise?

Mr. BARR. We are intensively supervising all banks for interest rate risk and liquidity risk. We look at all the ways that they measure interest rate risk and all the steps that they take to mitigate that risk. That could include, for example, hedging.

Mr. CASTEN. Are you compelling them to be more aggressive in light of the potential default on U.S. Treasuries that is coming up in a few weeks?

Mr. BARR. We are calling attention, really, to the broad range of interest rate risk. There is a heightened risk with respect to the debt ceiling that is part of that interest rate risk.

Mr. CASTEN. Are you going beyond the systemically important financial institutions (SIFIs) or do you not have the jurisdiction to supervise at that level?

Mr. BARR. The interest rate reviews that we do are for all of our banks. There is more intensive supervision and regulation of the global systemically important banks (G-SIBs), the largest firms. There is less-intensive but still quite active supervision on interest rate risks with respect to other firms.

Mr. CASTEN. Okay. If we blow up, and I would remind my colleagues that we expanded the debt limit every time when Trump was President, and every time in the last decade when Republicans have controlled the House, and when there has been a Democratic President, they have played suicide with the economy, and the last time we did downgrade our debt.

If we do that again, as we seem to be on a trajectory to do, and U.S. Treasuries are no longer a zero-risk security, how much capital will the banks have to raise instantly in order to be compliant with Dodd-Frank?

Mr. BARR. The obligation, obviously, is on Congress and the Executive Branch to work out an arrangement on the debt ceiling to raise it.

Mr. CASTEN. I understand that, and I hope we do, but the adults are not in charge. If we don't, are we going to force the banks to raise that capital? I don't like the politics of this any more than I think any of us do.

But my fear is that if we find ourselves with our prudential regulators and a choice of saying, do we provide stability to the banking sector and blow up the economy, or vice versa, none of us are going to like——

Mr. TIMMONS. [presiding]. The gentleman's time has expired.

The Chair now recognizes the gentleman from South Carolina, Mr. Norman, for 5 minutes.

Mr. NORMAN. I think you all have been here twice, and you have gotten a sense that there has not been a sense of urgency when it comes to the regulators or, as you put it, your supervisors.

With SVB, you had a bank that went from $71 billion to $200 billion in 36 months. You had a case where 94 percent of their deposits were above the limits of what it had insured. You had a risk-based officer who was not there. Who supervises the supervisors?

Mr. Barr, and then I will ask Mr. Gruenberg.

Mr. BARR. It is ultimately my responsibility to make sure we have effective supervision. We did not in this case and we are going to fix it.

Mr. NORMAN. Was anybody fired?

Mr. BARR. Not at this time. No, sir.

Mr. NORMAN. Not at this time. You have 22,000 employees. Nobody was fired. And taxpayers are going to suffer the consequences.

Mr. Gruenberg, you have, if my math is right, close to 2,800 examiners. Was anybody fired on this case?

Mr. GRUENBERG. No.

Mr. NORMAN. Nobody was fired?

Mr. GRUENBERG. Nobody has been fired. As I indicated, we have had the GAO report.

Mr. NORMAN. I get all that.

Mr. GRUENBERG. And we are in the process of doing a comprehensive review of our supervision program, including our staffing structure.

Mr. NORMAN. Could you walk me through, Mr. Gruenberg, your decision to backstop all of SVB's and Signature Bank's uninsured deposits? I get the systemic designation, but why was that decision made so quickly? And if you could do it quickly, because I have a question I want to ask Mr. Harper and Mr.——

Mr. GRUENBERG. I think this evolved over the weekend when Silicon Valley Bank failed. As you will recall, on Friday morning it became apparent to the FDIC as well as the State supervisor in New York that Signature Bank would probably be unable to open on Monday. So, we really had a circumstance—and the failure of Signature appears to have been prompted by a contagion effect from the failure of SVB. We also had information that other institutions were coming under significant stress.

Mr. NORMAN. I can tell you there is a good bit of stress that is going on right now. Is it both of your opinions that the banking system is in good shape right now?

Mr. GRUENBERG. I think we would both characterize it as resilient and stable.

Mr. NORMAN. So, it is in good shape?

Mr. GRUENBERG. I think it is in——

Mr. NORMAN. Okay. So, you don't have any concerns?

Mr. GRUENBERG. No. I made it clear in my written statement and in my oral statement that there are significant downside risks to which we are paying close attention.

Mr. NORMAN. Okay. Mr. Barr, are the banks in good shape now?

Mr. BARR. I would repeat also that overall, the banking system is sound and resilient. There are stresses in the system that were carefully marked.

Mr. NORMAN. Will they be acted upon? Will the supervisors show a sense of urgency? When you see the headwinds that these banks, SVB and others, have had, would you act a lot quicker now with the same—since no one has been fired, you have the same people in charge——

Mr. BARR. We would act with greater speed and agility and force.

Mr. NORMAN. Okay. Try to head this off, which would be a good thing. Okay.

Mr. Harper, the National Credit Union Association released a request for information on climate-related financial risk, which posed 38 questions about fiscal risk, transition risk, governance, and other topics. Is it appropriate for an agency to do this when it hasn't been approved by Congress?

Mr. HARPER. Our interest in this matter is, we are looking at all material risks to credit unions. We are gathering information related to climate——

Mr. NORMAN. What I am asking is, are you comfortable that none of what you are requesting has gone through the congressional review process?

Mr. HARPER. The congressional review process would not apply to a request for information, as I understand it.

Mr. NORMAN. Why?

Mr. HARPER. We have not adopted a rule and it would apply——

Mr. NORMAN. You are still making them—I don't know how many employees you have——

Mr. HARPER. We have about 1,200.

Mr. NORMAN. Yes, 1275, okay.

So, I guess you are comfortable without any direction of Congress requesting this information. You have the time and are putting your staff through answering these types of questions with climate risk.

Mr. HARPER. We passed this particular request for information on a 2–1 vote. The two was actually a bipartisan vote, if that is your concern. In addition to that, though, we are looking to gather information so that we can better understand what are the risks to this——

Mr. NORMAN. Do you know what the cost of this is to your bank?

Mr. HARPER. I'm sorry?

Mr. NORMAN. Do you know what the cost of complying and answering all these questions is to your bank?

Mr. HARPER. A credit union can choose to not answer it or to answer it.

Mr. NORMAN. Okay. So, it is voluntary?

Mr. HARPER. Yes.

Mr. NORMAN. Okay. I yield back.

Chairman MCHENRY. Thank you. The gentlewoman from Massachusetts, Ms. Pressley, is now recognized for 5 minutes.

Ms. PRESSLEY. Thank you so much to our witnesses for joining us.

Since Vice Chair Barr and FDIC Chair Gruenberg last testified in front of this committee, as we all know, another bank has collapsed. So that is three bank failures this year, and the Federal Reserve's report on the collapse of SVB underscores that bank executives committed, "textbook failures," in managing interest rate risk and regulators failed to understand the depth of the problem and to react appropriately.

Certainly, the 2008 financial crisis gave us all a front-row seat. The entire nation learned in that moment that we cannot solely rely on the decision-making of executives to ensure systemic stability. So, this is not a new issue. There is no epiphany here.

Chair Gruenberg, as you well know, and I want the public to know, banks are subsidized by the government through the Deposit

Insurance Fund and their access to the Fed's liquidity backup facilities. Banks perform what is essentially a delegated public responsibility including providing transactional accounts, operating payment systems, and serving as channels of monetary policy.

So, Chair Gruenberg, bearing this in mind, would it be fair to say that banks operate similarly to a public-private partnership?

Mr. GRUENBERG. They certainly have a public charter and a set of public responsibilities that comes with their charter and the provision of public support and that is also why they incur the obligations relating to both supervision for safety and soundness as well as consumer protection and community reinvestment.

Ms. PRESSLEY. Very good. Thank you. I think it is an accurate characterization. However, it is a skewed public-private partnership because the profits are enjoyed by the private bank but the losses are borne by the public.

For too long, banks have been content, really, to chase profits irresponsibly and then to turn to the government to bear the risk when they collapse. If the American public is going to suffer the consequences of poor corporate governance, then maybe it is time for the American public to have a seat at the table.

One proposal that would do exactly that is to give the government a special government share, or what some would call a, "golden share." The way it would work is simple. The Federal Government would receive a unique share in large banks that are considered systemically important, which would allow for a government-appointed director to join the bank's board and be responsible for representing the public interest.

Now, under normal circumstances the director would keep an eye on proceedings and not interfere with the day-to-day affairs, but when credible concerns arise that the bank is mismanaging its risk and threatening our economy, then the director can act as an early action system to prevent a potential crisis.

So, Vice Chair Barr, it is my opinion that having a government-appointed director at SVB could have helped to avoid the now-obvious mistakes and errors and repeat of history here. Do you agree that a board member with a unique public mandate would support remedial measures, early intervention, and then the director would have been more ideally positioned to spot and flag the problems with unhedged interest rate risk and overreliance on wholesale deposits that the executives were willing to ignore?

Mr. BARR. The system we have for that now is that the board of directors has that responsibility. They are required to oversee the management of the firm in a way that takes into account appropriate risk management, and in this case, the board failed to do that. The senior officers at the bank also failed to appropriately manage their risks, and as we outlined in a report, the supervisors called out those risks, cited them for the risks, but did not——

Ms. PRESSLEY. My time is elapsing. I am so sorry. Well, actually, I don't apologize. I am just going to reclaim my time.

You said, "failed," there several times and I think that is the point, that we don't want this to happen again. The swift government intervention to insure all deposits and prevent a systemic crisis showed us once again that the profitable business of banking is deeply intertwined with public interest.

The golden share proposal would allow an appointee on the board of large banks to safeguard the public interest. The recurring bank failures demonstrate that bank executives are not making decisions in the best interest of the people. The American people deserve a seat at the table. Thank you.

Mr. TIMMONS. [presiding]. The gentlewoman's time has expired. I now recognize myself for 5 minutes.

Mr. Barr, I know we have talked about this a lot today but do you believe that banks in the United States are well-capitalized?

Mr. BARR. I have said repeatedly that banks, according to our rules, are well-capitalized today. Our banking system is sound and resilient.

Mr. TIMMONS. So if you do believe that banks in the U.S. are well-capitalized, what is the point of your capital review?

Mr. BARR. The capital review is to look at whether the capital rules are appropriately meeting their objectives, whether despite the fact that the capital of the system is strong, it might be the case that it needs to be stronger, and that the banking system might need additional capital to be more resilient, precisely because we don't know the nature of the kinds of ways we might experience shocks to the system as has happened with these recent bank failures.

Mr. TIMMONS. So, it is your contention that the current regulatory framework is somehow inadequate. But you just said that you believe that banks are well-capitalized.

SVB did not fail because of inadequate regulatory capital. SVB failed because of a massive deposit run fueled by a social media blitz from some of the SVB's own depositors, concentrated uninsured deposits, and large volumes of assets bearing interest rate risks that the Fed missed.

So you, as the Vice Chair of Supervision, missed all of that until it was too late. How can anyone expect any framework of regulation to work if the regulators don't implement and enforce it?

Mr. BARR. We do need to focus on both. We need to focus on strengthening our system of supervision so that it is more agile, it is speedier, and it is more forceful, and we also need to make sure that we have the right resiliency in place in the system.

Ultimately, the depositors at SVB ran because they felt that the firm was not solvent. So, capital and liquidity issues are really intimately intertwined and that is why we are looking at capital standards.

Mr. TIMMONS. Well, it wasn't solvent. They were right. It wasn't solvent. But it was your job to make sure that they maintained solvency and I just don't understand how we are going to reassess capital requirements if the previous ones weren't faithfully implemented, and I don't see how this is productive.

Mr. BARR. The previous capital requirements were, in fact, faithfully implemented. The question is whether they were robust enough. For example, in SVB's case, had they been required to record their unrealized losses and gains on available-for-sale securities, that would have had a $2-billion impact.

Mr. TIMMONS. We are going full circle now. The first question I asked you is, are banks in the U.S. well-capitalized? It seems like the answer to that is possibly, no.

Mr. BARR. I am using the——

Mr. TIMMONS. You can't have it both ways. You can't say the banks are well-capitalized and also say that we need to reassess capital requirements.

Mr. BARR. We use the term, "well-capitalized," to describe a bank that exceeds our capital requirements as they currently exist. It doesn't make a comment with respect to whether those are the appropriate rules and that is what we are exploring as part of this review, and part of the joint work that the three agencies are undertaking with respect to the Basel III Endgame is, do we have capital requirements that appropriately measure risk and are those measurements robust enough to the kinds of shocks that we might experience in the future?

Mr. TIMMONS. The size of the runs on the banks that have failed would not be sustainable by any bank of their size. So, I don't see any capital requirement that could be imposed for certain banks that would address the concern. We are just going to move on.

Recent bank failures were prompted by poor interest rate risk management and asset liability management. To put it simply, failing at basic Banking 101 these banks did not appropriately recognize or manage the interest rate risk associated with a high proportion of unstable deposits and longer duration assets. This was widely recognized in recent post-mortem reports across your agencies.

Chair Gruenberg, why did the FDIC decide to base this recent special assessment solely off of uninsured deposits rather than use a risk-based assessment unique to each bank like traditional deposit insurance?

Mr. GRUENBERG. First of all, as you know, it is required under law to impose a special assessment to recover the cost of the Deposit Insurance Fund of this systemic risk exception. The systemic risk exception covered uninsured deposits. That is what it was used to do, and we have authority under the law to impose a special assessment on the institutions that benefited from the systemic risk exception.

As our staff reviewed it, we thought the most appropriate way to try to link the benefit of the systemic risk exception to the institutions that benefited was to track it with the amount of uninsured deposits.

Mr. TIMMONS. Thank you. I yield back.

And the gentleman from New York, Mr. Torres, is now recognized for 5 minutes.

Mr. TORRES. Thank you, Mr. Chairman.

The latest bank failures have held up a mirror to the two-tiered banking system in the United States. If your bank is too-big-to-fail, it has an implicit guarantee of unlimited deposit insurance.

But if your bank is too small to have an implicit guarantee of unlimited insurance then, in some sense, it becomes too-small-to-succeed.

Vice Chair Barr, how do you solve the problem of a two-tiered banking system in the absence of unlimited deposit insurance?

Mr. BARR. Let me start by saying that overall, our banking system is sound and resilient. Our community banks are serving their community. They are vibrant. They have been engaging and will

engage in efforts to make sure that they are safe. All depositors should feel that they are safe if you look at the actions that banks have taken recently to make that the case and regulators have as well.

So, I don't think that we have a structure where depositors should feel differently about their deposits depending on the size of the institution.

Mr. TORRES. But it is fair to say there have been outsized deposit flows to the biggest banks based on a perception of a two-tiered banking system?

Mr. BARR. We did have a period of time in the acute stress moment in March where there were significant deposit outflows from some regional institutions to larger institutions.

With the announcements that the agencies made and the establishment of the Bank Term Funding Program, deposit outflows for almost all institutions normalized to what they had been prior to that stressful incident.

Mr. TORRES. I want to speak about a new source of stress. New York City has the largest commercial real estate (CRE) market in the United States. Commercial real estate, particularly office space, is confronting the worst of both worlds: declining property values; and rising borrowing costs.

The combination of work from home and rapidly rising interest rates has been a calamity for office real estate, particularly Class B and Class C—$270 billion in CRE mortgages are reaching maturity in 2023, and a third of those mortgages are office.

Vice Chair Barr, or Chair Gruenberg, how high is the risk of commercial real estate causing a new wave of bank failures?

Mr. BARR. We are looking carefully at commercial real estate risks. As you point out, there are some downtown office commercial real estate deals that are especially vulnerable.

We are in a somewhat better position than in prior downturns in the sense that the loan-to-value ratios prior to the reset in pricing were muted, so in the price resets that we are likely to see, there is more capital than there had been in prior crises to absorb that.

There is also a lot of heterogeneity around the United States in terms of how exposed different banks are to those risks. So, I would say——

Mr. TORRES. Do you think any loan restructuring can or should be undertaken to prevent a cascade of defaults in the CRE market?

Mr. BARR. I do think that banks already are in the process of working out commercial real estate loans where they see those risks in appropriate places.

Mr. TORRES. For the Comptroller, before the creation of the OCC, there was no uniform national currency, only a cacophony of currencies. Each local bank could issue its own bank note, creating more confusion than clarity and ultimately ending in failure, hence the OCC.

In January of 2022, you gave a speech analogizing stablecoins to pre-Civil War banknotes. Left unmentioned in your speech, however, is the obvious difference between the fact that stablecoins, particularly dollar stablecoins, are pegged to a uniform national currency like the dollar.

Is it fair to say that a stablecoin system based on a uniform national currency like the dollar is qualitatively different from a pre-Civil War banking system that had no basis and no uniform national currency at all?

Mr. HSU. Thank you for the question. I think the uniformity has multiple dimensions to it. One is what it is pegged to, the one that you highlighted. I think that is one form of uniformity that is important——

Mr. TORRES. Which was absent from the pre-Civil War banking system?

Mr. HSU. I think that historians may debate that. In the pre-Civil War banking era, the issues where there was not uniformity was in the chartering and the supervision of the different banks and I think that is the case with stablecoins. The chartering, the supervision, and the standards to which stablecoins hold themselves are not consistent, and I think that is something to be wary of.

Mr. TORRES. Dollar stablecoins or——

Mr. HSU. I think all stablecoins.

Mr. TORRES. So if you had a fully-reserved stablecoin that is pegged to the dollar, in your mind, that is equivalent to a bank note that had no national banking system and no national uniform currency?

Mr. HSU. I think that is one important element of having a stablecoin that is prudent.

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

Mr. HSU. But I think there are other elements to which we want to pay attention.

Mr. TIMMONS. The gentleman from Wisconsin, Mr. Fitzgerald, is now recognized for 5 minutes.

Mr. FITZGERALD. Thank you, Mr. Chairman.

The NCUA recently released a request of information on climate-related financial risk, posing 38 questions about physical risk, transition risk, governance, and other topics.

Chairman Harper, regardless of the responses that you get back on this, I am just wondering where this came from and do you think it is appropriate for the agency to regulate in this area? There doesn't seem to be any clear directive from Congress along those lines.

Mr. HARPER. There are three things here. First, we have seen credit unions that have gone under. For example, we lost two credit unions after Hurricane Katrina went through that are related to climate-related financial risk.

Second, all of the regulators have been issuing requests for information (RFIs) in this area to gather information. If this were a definitive step forward towards regulation, we could have released it as an Advance Notice of Proposed Rulemaking. We didn't. We are gathering information so that we can help credit unions better understand what are the material risks on their balance sheets related to climate.

We know that certain institutions which are located in areas where there are greater risks have certain risks and they need to think about how do they mitigate those risks and offlay those risks.

Also, one of the things that the agency has done exceptionally well over the years is to develop tools for small credit unions to use, for example, our simplified CECL spreadsheet, as well as our automated cybersecurity evaluation tool. Both of those have helped credit unions to comply and to bring in and make sure that they are doing the right things in this area. We may well develop a tool, not necessarily regulation, in this area. But it is worthy of exploration.

Mr. FITZGERALD. I think the concern is—and I think many Members of Congress hear this on a regular basis—whether you have a group of credit unions in your office here in D.C. or back in the district, any time one of these requirements is put in place, for them, it is something they have to react to, and oftentimes, maybe even hire a full-time person to react to this.

And I am wondering, do you ever do kind of a look back on that to see just what type of impact you are having on credit unions?

Mr. HARPER. Certainly. One of the things that has been an agency principle for many years is looking at the size, scale, and scope of our regulations. We know that 3 out of 5 credit unions are less than $100 million in assets. They need to be focusing on their local communities and lending in their communities and making sure that the loans are getting paid on time and supporting the community.

Therefore, for credit unions under $100 million, we have scaled the regulations so that they have fewer things with which to comply. It is only as you grow in size and scope that you become subjected to more regulations.

For example, on our liquidity rules, credit unions above $250 million in assets are required to have access to a Federal backstop, either our Central Liquidity Facility or the Federal Reserve's discount window. We adjust accordingly because we do recognize the burden on communities.

Mr. FITZGERALD. Very good. Thank you.

Vice Chair Barr, after the questions asked by the Federal Reserve and the FDIC in the joint proposed rulemaking on the large bank resolution, we have heard some concerns that institutions could be assigned a bank category that does not necessarily match up with kind of the risk-based indicators that are out there. I am wondering if you have any comment on that, or if you are aware of this?

Mr. BARR. I am not sure I fully understand the concern. But we are taking into account and thinking about the proposal with respect to long-term debt requirements, and the risk profiles of institutions, so that does go into our thinking. I think what we saw——

Mr. FITZGERALD. And on capital standards that would be required, right?

Mr. BARR. Correct. We think about the risk basis for capital requirements as part of the work that we are doing together as agencies.

Mr. FITZGERALD. Okay. So, how many Matters Requiring Attention did SVB receive from the San Francisco Fed? Do you know what that number was?

Mr. BARR. At the time that the bank failed, it had outstanding 31 Matters Requiring Attention or Matters Requiring Immediate

Attention, which is about triple the average for that peer group, so quite a lot.

Mr. FITZGERALD. But of those 31, none of them really played a role in the downfall of the bank ultimately, right?

Mr. BARR. The issues that were raised in a number of those related to basic governance risk and controls, interest rate risk, and liquidity risk——

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

Mr. FITZGERALD. Very good. Thank you, Mr. Chairman. I yield back.

Mr. TIMMONS. The gentlewoman from Colorado, Ms. Pettersen, is now recognized for 5 minutes.

Ms. PETTERSEN. Thank you, Mr. Chairman. This hearing is timely and necessary now that we have more detailed information about what led up to the failures of Silicon Valley Bank and Signature Bank, the third and fourth largest bank failures in our nation's history.

Between Friday, March 10th, and Sunday, March 12th, the FDIC, the OCC, and the Fed acted as swiftly as they could to take stock of the assets, seek buyers, and then, when no suitable purchaser could be found, they quickly insured all depositors. Once again, I want to thank you for your timely action and for protecting small businesses and individuals throughout our country and in my district.

But a common theme today is that regulators were clearly able to identify problems with the risk management practices at Silicon Valley Bank and Signature Bank several years before their collapse. However, attempts at corrective action were slow and inconsistent.

Vice Chair Barr, you have said that you have the tools that you need to act differently in the future and you have also said that we need a culture that empowers supervisors. Were the delays and inconsistencies with the regulatory flags in part because of worrying about the backlash you might face from the industry and even some of my colleagues here in Congress if you actually utilized those tools?

What did you mean by stating that we need a culture that empowers supervisors?

Mr. BARR. We need to set up a system such that supervisors, when they are faced with uncertainty, act, and when they see a bank not responding promptly enough, they feel empowered to escalate those matters with putting in place, for example, limitations on capital distributions, incentive compensation, putting in place higher capital or liquidity requirements, and escalating matters to enforcement at a prompter speed.

I think that is a really important part of the kinds of reforms that we need to undertake.

Ms. PETTERSEN. Thank you very much. That leads me to my next question.

The FDIC issued warnings to SVB in 2019, 2020, and on 4 separate occasions in 2021. And then in 2022, SVB was prohibited from acquiring any other banks. In hindsight, we know that prohibition was insufficient.

Then in 2023, just 2 weeks before the bank failed, the CEO sold $3.5 million in stock. The employees of SVB received their annual bonuses on Friday, March 10th, just hours before the bank failure.

We will hear more from the executives tomorrow about this and it is concerning for me. But if regulators identify problems with risk management policies in capital and liquidity issues, do you think their executives should be able to sell stock and receive bonuses before the regulatory flags are addressed?

Would anyone like to take that?

Mr. BARR. I would be happy to address it.

I share your concern. I thought the fact that bonuses were paid the day the bank failed was outrageous. We are investigating that. We will take full action, depending on the findings of that investigation.

With respect to the stock sales, that is, generally speaking, an issue for the SEC and I would defer to them on it.

Mr. GRUENBERG. Congresswoman, I would add that in addition to the authorities that the Fed has in regard to SVB, as part of our resolution of SVB the FDIC has a legal obligation to investigate the board and management of the institution for any misconduct that may have occurred, and we have considerable authorities, including ordering restitution and also banning individuals from the business of banking if our investigation finds appropriate misconduct, and those investigations are underway now.

Ms. PETTERSEN. Thank you for that information.

Quickly, Mr. Hsu, you have said that our deposit insurance should be updated and you have also recognized the balance between higher coverage and higher costs.

What considerations should we be making when we look at balancing the increased cost with protecting depositors and the risks that bank runs pose to our entire economy? Should we be treating individual depositors differently than small businesses, and what could a tiered approach look like? You have 30 seconds.

[laughter]

Mr. HSU. Well, thank you for the question.

The FDIC report on deposit insurance lays out the tradeoffs really well, so I encourage folks to look at that. There are some hard balances to be made between financial stability and some of the moral hazard issues that are out there. I think the report does a really good job of laying that out and we look forward to working with you and others on working through that.

Ms. PETTERSEN. Great. Thank you all so much for being here. I yield back.

Mr. TIMMONS. The gentleman from New York, Mr. Garbarino, is now recognized for 5 minutes.

Mr. GARBARINO. Thank you, Mr. Chairman.

Chairman Harper, in addition to serving on this committee, I am also the Chair of the Cybersecurity and Infrastructure Protection Subcommittee of the House Homeland Security Committee. One thing that I have continually heard from industry is that there is a need to harmonize cyber regulations across the Federal Government.

As I am sure you are aware, the National Credit Union Administration board approved its final rule on cyber incident reporting re-

quirements this past February. It is my understanding that while not fully implemented, this rule directly conflicts with congressionally-mandated cyber incident reporting for the Cyber Incident Reporting for Critical Infrastructure Act (CIRCIA) that we passed and was signed into law last year.

Did the NCUA work with Director Easterly at the Cybersecurity and Infrastructure Security Agency (CISA) or any other Federal entity on the development of this proposal, and did you analyze how your 72-hour rule interacts with existing regulations and laws?

Mr. HARPER. Certainly, we did fully consider the CISA rules, and in fact, we aligned ours with the 72-hour limit to be with theirs. What we see is this should be a hand-in-glove work.

We don't want any conflict between the two, and if there is conflict, we will work to resolve it. But it is my understanding, according to staff, that we have resolved that already and there is no conflict.

Mr. GARBARINO. Okay. Someone from the American Bankers Association came in front of my subcommittee and said that 40 to 50 percent of their employees' or cyber employees' time is spent dealing with regulations. So if there is conflict, which I believe there is some, I think it would be great if you worked with CISA to make sure that whatever reporting they have to do is not duplicative and that these cyber employees need to focus on defense instead of——

Mr. HARPER. No, I fully agree.

Mr. GARBARINO. And it is also my understanding that the NCUA will provide additional guidance prior to the final rule going into effect but it is yet to be provided. Do you have a date on when that will be available?

Mr. HARPER. The rule itself goes into effect in September. We are working to set up the reporting systems, and once we have those details ironed out, we will provide that additional guidance.

In fact, we will be having a card with reportable/not reportable to help make it much easier to understand what instances would arise.

Mr. GARBARINO. I appreciate that. Thank you.

Mr. Gruenberg, I have a question about the FDIC special assessment.

Unlike traditional deposit insurance, which leverages a risk-based assessment unique to each bank, the FDIC's proposed special assessment rulemaking leverages uninsured deposits as a mechanism to assess banks.

To what extent is there a variation in the overall stability of uninsured deposits and to what extent would this framework differentiate across uninsured deposits that may have different characteristics?

Mr. GRUENBERG. I think the proposed special assessment is really based on the amount of uninsured deposits that a particular institution has because the extraordinary action that was taken under the systemic risk authority was really focused on protecting uninsured deposits.

So, the assessment would be across-the-board, based on the amount of uninsured deposits an institution has, but there is an exception built in, so all institutions with less than $5 billion of un-

insured deposits would be exempted. That way, community banks are exempted from the application, and the burden really falls principally on institutions with assets over $50 billion.

Mr. GARBARINO. So, you are saying that the special assessment is purely based off of the amount of uninsured deposits and it doesn't matter? That was the only reasoning——

Mr. GRUENBERG. Yes.

Mr. GARBARINO. ——is because of what just——

Mr. GRUENBERG. That is what was protected under the systemic risk exception. The statute gives us the authority to target the special assessment on the institutions that benefited from the systemic risk action and that was really the basis.

Mr. GARBARINO. Because uninsured deposits were protected, that is the only reason we are basing the assessment off of uninsured deposits, moving forward?

Mr. GRUENBERG. That is correct, Congressman.

Mr. GARBARINO. Okay. Thank you.

Mr. Barr, just quickly, separating recent bank failures from changes to capital requirements, recent reports show that the Basel III revisions proposal could result in a 20-percent increase in capital levels for the largest banks, marking arguably the most comprehensive overhaul of the regulatory framework, for which the industry would only have a few years to comply.

According to economic literature by the Basel Committee on Banking Supervision, a one point increase in capital requirements could potentially reduce annual GDP by up to 16 basis points. What impact on lending in the real economy do you think such swift and strident requirements will have and how are you controlling this?

Mr. BARR. Any rule changes we make would go through the notice-and-comment rulemaking process and have appropriate transition. So, we are not talking about something that is immediately effective.

Mr. TIMMONS. The gentleman's time has expired. The gentleman from New Jersey, Mr. Gottheimer, is now recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Mr. Chairman.

Since the rapid bank failures we witnessed in March, there has been a wave of uncertainty rippling through the banking system. Regulators took action following those failures to help protect depositors and ensure their funds were safe in other well-managed banks that do not suffer from the same issues that plagued Silicon Valley and Signature Banks.

Following the collapse of those two banks, however, I have heard reports from small, medium-sized, and regional banks coming under pressure from short sellers hoping to benefit from the turmoil in the banking sector by driving down the value of banks in the same asset class as those who failed.

Vice Chair Barr, if I can start with you. I sent a letter to the SEC today encouraging the Commission to monitor for illegal and abusive short-selling practices and to use appropriate authorities to prevent misconduct in financial markets. In the SVB report, you wrote that despite recent events, our banking system is sound and resilient with strong capital and liquidity.

Are there wider systemic issues at play threatening the competitiveness of small and regional banks or is it your sense that these short sellers are trying to make a quick buck by taking advantage of uncertainty in the banking sector?

Mr. BARR. I do think the banking system is sound and resilient. There are a number of banks that have come under recent stress. Some of that has to do with a rapid decline in their stock price, which is a function of short interest and also a decline in long interest, and those factors together have reduced the market value of those firms, and that puts additional pressure and stresses on the banking system.

Mr. GOTTHEIMER. Do you think social media is also at play there?

Mr. BARR. I do think the role of social media has been intensified. Certainly, with respect to Silicon Valley Bank, the speed with which the bank failed was something that had not been seen before and that is a function, in part, of social media and part of the highly networked concentrated depositor base of that institution.

Mr. GOTTHEIMER. Thank you. Do you think the SEC should do everything in its power to identify sort of misconduct in financial markets like those and block that kind of activity or abusive trading strategies? There are, of course, short and long markets. But what if we are seeing abusive practices?

Mr. BARR. As you mentioned, that is a matter for the SEC.

Mr. GOTTHEIMER. Thank you. In reading your report on SVB, I found it alarming that the Fed was aware of many factors that ultimately led to the bank's collapse as, obviously, others have pointed out today, but failed, in my opinion, to move quickly and forcefully enough to prevent its failure.

In the report, you outline recommended changes for the Fed Board to consider related to its supervision and regulation of the banks. As you consider changes to the Fed's oversight of the banking system, how will you ensure that small, medium-sized, and regional banks remain competitive?

Mr. BARR. We are looking very carefully at the impact that any change would have on our banking system. As I mentioned at the outset, I think having a diversity of institutions is absolutely critical for our country. We are well served by having a wide range of community-based institutions, regional banks of different sizes, as well as our largest institutions.

So, the kinds of approaches that we are taking in the main will be focused on larger institutions, institutions over $100 billion in size. We haven't seen these difficulties with respect to our smaller institutions, so the approach we are taking will be one that is really focused on that risk.

Mr. GOTTHEIMER. Right, and we need those smaller institutions——

Mr. BARR. Absolutely. As many of you know, in your own communities, community banks play a vital role in their local communities with small business lending, support for community activities, and engagement in the community. They really know their market and serve it well.

Mr. GOTTHEIMER. Thank you so much. Small and medium-sized banks, I agree, play a crucial role in our communities, so I am grateful for your comments.

Chairman Gruenberg, earlier this month the FDIC released a set of recommendations for reforming deposit insurance. You listed three main options for reform: limited, unlimited, and targeted coverage of deposits. Can you briefly explain these options for reform and potential implications for the competitiveness of small and medium-sized banks in particular?

Mr. GRUENBERG. Thank you, Congressman.

We did lay out three broad options. The first option is essentially keeping the system the same as today with possible upward adjustment of the coverage across-the-board, but not full coverage. The second option would be full coverage. And the third option is what we call targeted coverage, which is particularly focused on business payment accounts.

Of the three, we thought the one that best balanced the objectives of enhancing financial stability while mitigating moral hazard was the third option, the targeted approach on business payment accounts.

Mr. GOTTHEIMER. How do you think that would affect, if you could just in the last 20 seconds here, the implications for competitiveness of small and medium-sized banks, and regional banks, in particular?

Mr. GRUENBERG. To the extent that they particularly serve small businesses, small businesses rely on those business payment accounts. Investor Relations coverage would actually be of benefit to smaller institutions in that regard.

Mr. GOTTHEIMER. Thank you. I yield back.

Chairman MCHENRY. The gentlelady from California, Mrs. Kim, is now recognized for 5 minutes.

Mrs. KIM. Thank you.

And thank you all for being here. The recent bank failures have been anything but transitory. Since SVB's failure, I have reached out to many of my contacts—regional banks, community banks, and countless executives from small and medium-sized financial institutions in my region—to first gather input and to check in on them and get their thoughts on those bank turmoils and the proposals being debated.

Smaller financial institutions agree that they don't want the Federal Government to use the recent crisis as an excuse to increase regulations and reduce liquidity in the market through stronger capital requirements.

Vice Chair Barr. I know you assumed the office in July of 2022, so from the time you took office to the time of SVB's failure, you had been sworn in for nearly 8 months. Could you please tell the committee what your top priorities were during those first 8 months in office?

Mr. BARR. The bulk of my time was spent looking at a holistic review of capital, which we conducted and are in the process of completing, working with the very largest firms, the G-SIBs, looking at putting in place a long-term debt requirement for firms to enhance their resiliency, looking at the ways in which we could im-

prove the way that we look at bread-and-butter issues like interest rate risk and liquidity risk.

Mrs. KIM. Sure. Bread-and-butter issues.

Mr. Barr, thank you so much. But I know a lot has been said about the interest rates too. With interest rates increasing as a result of high inflation, did you and your office ever make the interest rate risk or bank mismanagement a priority during those first few months in office?

Mr. BARR. Yes. As I mentioned, interest rate risk and liquidity risk are bread-and-butter issues of supervision. The staff has increased attention on that as a result of increases in interest rates.

We issued a report in the fall of last year that highlighted interest rate risk as a core risk. So, there has been an ongoing process to make sure that interest rate risk is appropriately addressed by supervisors.

Mrs. KIM. It is alarming that the Fed knew of the alarming interest rate risk through the forward guidance. Yet, according to some reports, not since 2015 has a stress test involved rising interest rates. Instead, the Fed interest rate scenarios assumed a fall to near zero in every case. So, to me, it seems that the Fed is focused on addressing the risks of the past when we must be focusing on the risk of the present.

Last month, NFIB also said that small businesses were facing more difficulty getting a loan than at any time in the past decade. We already have a very fragile economy where small businesses need reliable and affordable access to credit.

I am going to ask you a couple of questions all at once. How are you assessing the tradeoffs between higher capital and strong economic activity and credit, and have you engaged with small business stakeholders to fully understand the impact that the conclusions of your review will have on them?

Mr. BARR. Thank you very much.

First, with respect to stress testing, I agree there should be multiple scenarios for stress testing, including testing rising rate environments. We are doing a pilot test of that this year with respect to a market shock and we intend to issue a proposal about multiple shocks, going forward. So, I agree with you about that.

With respect to capital requirements, we are looking at proposals that will go through notice-and-comment rulemaking and then have a transition period for them.

So, we are thinking about capital requirements that apply well out into the future. We are not thinking about or we are focused on today because the capital requirements would apply after an appropriate transition period.

Mrs. KIM. Do you have a timeline for those holistic reviews and when do you plan to release the timeline?

Mr. BARR. I expect that this summer, the holistic review will be complete, and the interagency process with respect to the Basel III Endgame will also be complete and we will be able to speak about those issues in detail, and then the public can comment on those and we can take feedback.

Mrs. KIM. Okay. Mr. Hsu, in a bulletin issued on April 26th, the OCC stated that because——

Chairman MCHENRY. The gentlelady's time has expired.

Mrs. KIM. Mr. Chairman, thank you so much. I yield back.

Chairman MCHENRY. The gentlelady's time has expired. The gentleman from Nevada, Mr. Horsford, is recognized for 5 minutes.

Mr. HORSFORD. Thank you to the chairman and the ranking member for the hearing today and to our panelists for testifying.

I want to begin by discussing Community Development Financial Institutions (CDFIs) and Minority Depository Institutions (MDIs), and what we are doing to expand and to protect them.

According to the latest list of federally-certified CDFIs from April 14th, 2023, Nevada has only two CDFIs: the Greater Nevada Credit Union; and the Rural Nevada Development Corporation.

Additionally, based on data available, there are zero chartered in the State of Nevada. This is completely unacceptable. It is something that I have been working with the Deputy Secretary of the Treasury on, and I hope that I can enlist your support today, particularly because Nevada is one of the most diverse and growingly diverse States. With a vital mission of supporting capital investments to historically-excluded communities, these institutions are immense drivers of economic mobility.

I know that the CDFI Fund has taken steps to overhaul its certification process after concerns were raised that certain firms were not truly focused on uplifting the communities that they are meant to serve. I think these need to be decertified, in fact.

Vice Chair Barr, CDFIs and MDIs which serve small businesses and communities are feeling the pinch of tighter credit standards, and are also feeling a pinch of their own with investors and larger banks pulling back on lending. Does this trend signal to you that we need stronger incentives such as the Community Reinvestment Act so that banks are encouraged to make investments in those community financial institutions that I mentioned?

Mr. BARR. Yes, I think you raise an important issue, and I have been working on ways to support the Community Development Financial Institution field and the MDI field for more than 25 years. I think that they do absolutely critically-important work in serving their communities. The joint interagency proposal on the Community Reinvestment Act does increase the incentives on banks to serve local communities, including through support for CDFIs and MDIs, and I look forward to working with my colleagues here to finalize that rule.

Mr. HORSFORD. Thank you.

Chair Gruenberg, banking agencies are required under the law to preserve and promote Minority Depository Institutions. Are there reforms that the FDIC and Congress can consider to ensure resolution planning and resolution procedures provide better opportunities for MDIs to participate in the acquisition of a failing bank, perhaps through a joint bid or being able to take part of the business being sold?

Mr. GRUENBERG. Thank you, Congressman.

That is an important issue to which we have devoted considerable attention. When we have had instances in which an MDI is going to come under stress and has a risk of failure, our resolution division works with other MDIs to see if we could facilitate an acquisition of the troubled institution by another MDI to ensure it

continues its status and mission as a Minority Depository Institution.

In regards to when a larger institution may enter resolution, there is an opportunity for MDIs to partner with other larger banks that may be interested in making the acquisition in order to participate, and that is something we also make part of our resolution process.

Mr. HORSFORD. Thank you.

Acting Comptroller Hsu, I read your written statement and I agree with your assessment on the importance of revitalizing MDIs. 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. You stated that the number of MDIs has decreased, and they have historically faced challenges with accessing capital, adopting new technology, and modernizing their infrastructures.

In July of 2022, the OCC issued an updated policy statement on MDIs that reaffirms the agency's commitment to these institutions and describes the range of the programs in place to support MDIs. I am also aware of the Project REACh program that you have initiated. Can you elaborate on any other efforts the OCC has underway to support MDIs?

Mr. HSU. Sure. If I can just say a quick word on Project REACh, as part of that program, one of the four major workstreams is revitalizing MDIs. And one of the main tools we have used is a pledge from larger banks to commit capital and to commit technical assistance to MDIs as combined with the Emergency Capital Investment Program (ECIP) money and others. There is basically wind at the backs of some MDIs now, and we are looking to capitalize on that, working with larger institutions partnering with MDIs.

Chairman MCHENRY. The gentleman's time has expired.

The gentleman from Nebraska, Mr. Flood, is recognized for 5 minutes.

Mr. FLOOD. Thank you, Mr. Chairman.

We have spent a lot of time today examining the specifics of the Federal Reserve's report on the collapse of the Silicon Valley Bank. That is a very important topic, no doubt. But I would like to focus my questions today on the FDIC's report on deposit insurance.

Chairman Gruenberg, the FDIC's report on options for deposit insurance reform recommended an expansion of deposit insurance for business payment accounts. If business payment accounts were fully covered under deposit insurance, can you speak to how the FDIC would change banks' assessments to pay for the increased insurance?

Mr. GRUENBERG. Depending on the increase in the Deposit Insurance Fund, assessments would have to be increased to account for that, and that is really one of the tradeoffs here. If you are going to consider ways of expanding the coverage of deposit insurance, you really have to balance it against the cost to the industry of increased assessments.

It is one of the reasons that among the options we reviewed, we thought that a targeted approach focused on business payment accounts, which is valued by businesses, valued by the banks for the relationships that they can develop with businesses, has particular

promise because of the impact the failure of a bank with business accounts could impose; it could have financial stability implications. But because of the narrow nature of the account, if a bank has a business payment account, where they are a small business, it is really not in a position to open up multiple accounts. They really need the one account with the one bank.

Mr. FLOOD. For the payroll, basically?

Mr. GRUENBERG. Yes, for the payroll. In terms of moral hazard, it is mitigated. In terms of financial stability, it is meaningful. So if you are going to look at increasing coverage, that was the place we thought it might make the most sense.

Mr. FLOOD. And when you explain this, how are you thinking about community banks when it comes to these assessments? Obviously, Nebraska is full of really healthy, good community banks. They are talking to us about how they are going to weather this storm with potential assessments. How do you see that happening with this change in FDIC insurance?

Mr. GRUENBERG. Look, I think this kind of account would arguably be particularly beneficial to smaller institutions because they have close working relationships with small businesses. It is really their bread and butter, so being able to offer higher coverage for these business payroll accounts might have particular appeal.

You really have to think through the costs associated in terms of, we want to go down this path where you might——how high you might want to go, how high the coverage might be.

Mr. FLOOD. So when you go in and conduct an examination on one of these banks, do you have the resources now to be able to look at when your examiners go in there, and they start sifting through all of the different depositors of an institution, do you have the resources you need now to be able to effectively regulate this change in FDIC insurance? Or do you need more people for that?

Mr. GRUENBERG. Yes, that is an important question, and we highlight this in the report. If you are going to go down the path of considering higher coverage for business payment accounts, there is an issue of definition, and you want to be sure you have clarity so that we are covering the kinds of accounts that we are really intending to and, in a sense, don't broaden deposit insurance coverage for other kinds of accounts that really don't serve the purpose.

So there will be, I think, an operational challenge in implementing it, and that is something to which our examiners would have to be attentive. It is one of the issues we would have to work through if we wanted to go down this road, and it would require a legislative change.

Mr. FLOOD. And the last thing I wanted to talk about is if you make these changes, you have to regulate, you have to examine. I worry about increased compliance burden on the banks, on the insured institutions. I would caution that we have to remember these small community banks serve rural America very, very well, and any additional compliance expectations make it hard for a lot of these—take chartered banks that are serving an agricultural community—to exist.

I will just give you a chance to react to that.

Mr. GRUENBERG. No, we are keenly attentive to that, and we do have some experience, as we outlined in the report. During the aftermath of the 2008 crisis, we did implement the Transaction Account Guarantee (TAG) program, which was a variation of this type of account, and it was extensively used, particularly by smaller community banks. And they found it quite beneficial.

Mr. FLOOD. My apologies. My time has expired.

I yield back.

Chairman MCHENRY. The gentlelady from Michigan, Ms. Tlaib, is now recognized for 5 minutes.

Ms. TLAIB. Thank you so much, Mr. Chairman.

Everyone keeps talking about, could the regulators have been faster and more forceful? Absolutely. Did the Trump-era deregulation shield Silicon Valley from enhanced supervision oversight? No doubt about it.

However, at the end, I want to talk about the real root cause of Silicon Valley's failure: It was their mismanagement and personal greed. And if you look at the timeline, gentlemen—I really want us to look at this—at the end of the day, as you can see, some of the decisions made by senior bank employees led to their downfall. And partly, these decisions were all shaped by compensation packages that incentivized unsound risk-taking. Would you agree, Vice Chair Barr?

Mr. BARR. Yes, I do think that bank mismanagement was at the core of this.

Ms. TLAIB. Yes.

Mr. BARR. And in the incentive compensation plans that the board put forward, risk management was not included in that at the time the bank failed.

Ms. TLAIB. Yes. Look at last year. The CEO's salary was roughly, what, $1 million? But then, he enjoyed over $5 million in stock awards and $2 million in stock options. During that time, did they get something from the Federal Government that said, hey, something is going on here? Didn't they, around that time? When did they get contacted by the Fed?

Mr. BARR. With respect to their risk management issues?

Ms. TLAIB. Yes.

Mr. BARR. They were contacted throughout this period of time, beginning early in 2019, and in 2020, 2021, and 2022.

Ms. TLAIB. That is right. So, in 2021, this is what he does. I was just asking because I am literally looking for the money. I am like, "cha-ching, cha-ching." All I can see is personal gain here.

This is not even on the table. There wasn't room for it regarding the $5 million, I think, stock exchange. But Mr. Becker has also earned $6 million since 2020 from bonuses based on the net income. In 2021, that meant an extra $3 million.

As depicted in the slide, last year the Silicon Valley Bank unwound billions of dollars' worth of interest rate swaps. Is that correct?

Mr. BARR. Yes, they did. They removed interest rate hedges.

Ms. TLAIB. This does not make any sense in terms of protecting against rising interest rates, but it does make sense when your compensation depends on the bank's net income, or what we call in Detroit, "a.k.a. personal gain for bank executives."

Terminating the swaps may have left them even more vulnerable to rate increases, but it boosted the bottom line likely out of red and into black. Why do you think they did that, Chairman Gruenberg?

Mr. GRUENBERG. For financial benefit, Congresswoman.

Ms. TLAIB. That is right. No, I really want to make the American people understand what exactly happened because everybody is so focused on what you all did or did not do. But at the end, they didn't respond. Did they respond to any inquiries that you put in, Vice Chair Barr?

Mr. BARR. The bank did respond to regulator citations but those responses were insufficient. They were not sufficiently-timely and sufficiently-aggressive.

Ms. TLAIB. My colleagues did talk about Section 956, and I know all of you are working on it. Correct? You all agreed that you are working on it, which is important. Because I really think you actually have the capacity and probably the legal authority to go ahead and claw back.

Do you agree that part of this proposal that you are looking at in regards to implementing Dodd-Frank's Section 956 regarding extreme compensation, bonuses, and so forth, is going to include a clawback?

Mr. BARR. The proposal that was drafted in 2016 included a claw-back provision and——

Ms. TLAIB. Are you all talking, yes or no, is a clawback going to be one of the things that you are going to include in your proposal?

Mr. BARR. I will say personally I think having that kind of provision makes a lot of sense. We haven't reached a determination as a group.

Ms. TLAIB. Yes. American people want you to do the clawback. Trust me.

How about you, Chairman Gruenberg?

Mr. GRUENBERG. Yes, Congresswoman.

Mr. HSU. I think it is very important that we have a strong executive accountability. So, yes.

Ms. TLAIB. Chairman Harper?

Mr. HARPER. Yes on clawback, and we need to make sure that it would have applied in those situations you described.

Ms. TLAIB. Oh, absolutely. I think it is important because I am working on a bill right now, because, not that I don't trust you all, but I saw what happened in 2016. And so, I am working on a bill because it has been 12 years.

And I want to work on establishing rules that literally curb the incentive compensation structures that also will help create kind of like a fund almost, and again, I would welcome your feedback. But it basically would require senior bank employees' compensation to be set aside to deferral funds and clawed back if executives break the law.

Because this is like a scam. I know you all are not allowed to use that word, but I am going to use it. That is a scam. And no one is focused on the bank. They are focused on, oh, what should we do here?

This is not the last bank that will do this because of greed, and we, the American people, are going to have to pay.

Thank you. I yield back.

Chairman MCHENRY. The gentleman from Ohio, Mr. Nunn, is now recognized for 5 minutes.

Mr. NUNN. Thank you, Mr. Chairman. And I will submit that it is the great State of Iowa.

Chairman MCHENRY. I'm sorry. The gentleman from Iowa.

Mr. NUNN. Absolutely.

Chairman MCHENRY. My apologies for the Chair's mumbling. The gentleman from Des Moines, Iowa, Mr. Nunn, is recognized.

Mr. NUNN. Mr. Chairman, it's very much a privilege.

And we are going to talk a little bit about Des Moines, Iowa, today. As a freshman on this committee, in the last 3 months we have seen 3 massive bank failures.

Last week, I got to take my 16-year-old out to get a first car loan. The scariest thing about your 16-year-old driving shouldn't be the question of, is my bank going to be there next month as a result of what has been going on here?

I want to highlight the fact that everyone has now concluded on this committee that it is not fair for my small mom-and-pop bank in a place like Creston, Iowa, which has 96 percent of its depositors insured, to pay for this risky lending behavior, particularly by banks like Silicon Valley Bank, where just over 1 percent were insured.

So I want to begin, first of all, by applauding Chairman Gruenberg for heeding the advice of this bipartisan committee, as well as the work that you have done to ensure that small banks were not punished by the FDIC's special assessment.

Mr. Chairman, I want to go a level deeper here. Do you think that, going forward, regular deposit insurance assessments should also factor in the unusually large levels of uninsured deposits? Why or why not?

Mr. GRUENBERG. I think the answer, frankly, is probably yes. It is one of the things we identify in our report on deposit insurance. One of the tools we have is risk-based pricing. And in light of this episode, we may want to consider increasing risk-based pricing based on levels of uninsured deposits. That is certainly something we have the authority to do and something we can look at.

Mr. NUNN. And I appreciate you looking at that. I am going to take it to the next level then.

Why should banks that are under more-conservative management or higher FDI like my rural guys in Iowa have to pay the same pro rata premium assessments as those banks that take on this greater risk?

Mr. GRUENBERG. They shouldn't, and we do have a risk-based pricing system. The challenge here is getting the risk-based pricing right. And for uninsured deposits, there may be a risk factor of which we need to take better account.

Mr. NUNN. So is the FDIC prepared to take a more serious look at some of the risk-based calculations, and do you have a plan for how you are going to do that?

Mr. GRUENBERG. That was outlined in our report, and it is something on which we are going to follow through.

Mr. NUNN. I am heartened by that, and again, I thank you for taking a holistic approach to that.

Vice Chair Barr, last Friday, your fellow Governor, Michelle Bowman, gave a speech where she stated, "We should be careful and intentional about any significant changes to the regulatory framework, including imposing new requirements that will materially increase funding costs like higher capital requirements."

She has agreed with many of us here on this committee that the bank failures that we saw were the direct result of mismanagement and supervision, not the current capital regulatory requirements that some on the other side of the aisle may say. Do you agree or disagree with Governor Bowman on her assessment?

Mr. BARR. I agree that we should be careful and prudent in thinking about how to make capital changes. I do think it is appropriate for us to look at whether capital requirements for firms $100 billion and above are appropriate in the current circumstance.

One area we are looking at in particular, for example, is whether we should use the rule that changes in the value of available-for-sale securities should be taken into account in the capital requirements. If we do make such a change, we would do that through a normal notice-and-comment rulemaking process with appropriate transitions. That is one example.

Mr. NUNN. And I respect that example. My concern here is that, in the words of Winston Churchill, "never let a good crisis go to waste." And I am concerned that the Fed specifically is looking at exploiting what has happened over the course of the last 3 months with these 3 banks as an opportunity to really open up the regulatory channels and start governing by fiat in a way that, really, it should be in the role of Congress.

Would you agree that you are going to be caging yourself after this series of committees on what I think is really some regulatory overreach, given that there are three very unique banks here that don't reflect the larger financial sector?

Mr. BARR. We will be looking at capital in the system as a whole. I began a holistic review of our capital requirements in July when I arrived. I think that it would be prudent for me and for my fellow regulators to take into account what just happened to our banking system rather than to close our eyes to that. So, I do think it is important——

Mr. NUNN. I appreciate that, but I think Governor Bowman said it very clearly here. You have the capability to go after these banks. When Silicon Valley Bank took out a massive level of risk, when they had the opportunity to have a risk officer who was asleep at the switch or not even existent for 8 months, we had a diversity of other positions included, you had the ability to go after SVB. And as even my colleagues on the Democratic side have highlighted, those safeguards were not protected.

So, I have a real concern when we think about exploiting a crisis to have more regulatory authority when you have those tools already in your toolkit.

With that, I will yield back.

Chairman MCHENRY. The gentleman from North Carolina, Mr. Nickel, is now recognized for 5 minutes.

Mr. NICKEL. Thanks so much to our witnesses for your testimony today. I appreciate you coming back, those of you who did, for the second time in 2 months.

Vice Chair Barr, Chairman Gruenberg, I also want to thank you for your hard work in reviewing the recent bank failures and keeping the committee informed, and for being here for quite a while today. I know we are near the end, and it has certainly been a long day.

As I told you the last time you were here, my constituents are worried about making ends meet, and the last thing they need to worry about is their bank failing. I am looking for more accountability. That is really the focus of my first set of questions here, Vice Chair Barr. My constituents deserve to know that we will hold bank executives and regulators accountable and ensure that this doesn't happen again.

Vice Chair Barr, the Fed's report says that supervisors, "did not fully appreciate the extent of the vulnerabilities as Silicon Valley Bank grew in size and complexity and did not take sufficient steps to ensure that SVB addressed its problems quickly." And I asked you this the last time about accountability, who was asleep at the wheel? Now that you have had more time to review this matter, can you tell me about individual accountability?

Mr. BARR. Ultimately, I am accountable for ensuring that our supervision and regulation is effective. It was not in this case. And I can tell you I am committed to making significant changes to make sure that doesn't happen again.

Mr. NICKEL. Was anyone fired?

Mr. BARR. There have not been any employees of the Federal Reserve fired as a result of this. We did not find any unethical conduct. We did find judgments that could have been better and actions that could have been stronger, and as I said, I am committed to fixing that.

Mr. NICKEL. Thank you. I would like to move on to capital requirements.

This morning, I received your answers to my questions for the record from our last hearing, and I have some follow-ups. Access to capital for small businesses, especially minority-owned businesses, is one of my top priorities. There is a thriving community of startups in my district. Many of the biotechnology companies which are saving, extending, and improving lives rely on banks for capital.

I am alarmed by increasing reports of a credit crunch, particularly for small business owners and minority business owners who are likely to be hit hardest by this. The Basel III Endgame rule expected later this year will materially increase the capital requirements for banks. This will limit these banks' ability to lend into the economy and support capital formation in areas like mine in North Carolina.

Just to be clear, Vice Chair Barr, banks under $100 billion will not be subject to increased capital requirements?

Mr. BARR. That is right. The focus of our reform efforts with respect to capital is on banks over $100 billion in size, and the potential significant increases in capital requirements are really focused on very large firms with very large trading operations, not with respect to smaller firms serving small businesses.

Mr. NICKEL. Have you considered the impact that higher capital requirements might have specifically on minority-owned businesses that already face significant barriers to accessing capital?

Mr. BARR. Yes. We look at the impact of a rule across-the-board, including its effect on small business lending, when making adjustments. As I said, the adjustments we are thinking about with respect to the Basel III Endgame that the agencies together are considering are primarily about significant adjustments to the trading book for the very largest financial institutions in the country. They are not about small businesses' access to credit.

Mr. NICKEL. Specifically, though, I am asking about the impact capital requirements will have on minority small business owners. Have you conducted any analysis in your holistic review on this?

Mr. BARR. We don't currently anticipate that the kinds of changes that we are talking about would affect the institutions you are talking about. We are really focused on capital requirements on the largest institutions in the country which have very active trading books and that is primarily driving the changes in Basel III Endgame.

Mr. NICKEL. When we consider the structural barriers for minority entrepreneurs—the rising rate environment, inflation, and again, reports of a credit crunch—do you think this is really the best time to get into raising capital requirements?

Mr. BARR. As I have said, any rulemaking that the agencies do would be a formal notice-and-comment rulemaking with an appropriate transition period. So, we are not trying to design capital requirements for tomorrow. We are thinking about in several years, what should capital requirements look like when fully implemented?

Mr. NICKEL. Thank you so much. And Mr. Chairman, I yield back.

Chairman MCHENRY. The gentleman yields back. The gentlewoman from Texas, Ms. De La Cruz, is recognized for 5 minutes.

Ms. DE LA CRUZ. Thank you so much, Mr. Chairman.

And thank you to all the witnesses for being here today.

I would like to start with Vice Chair Barr. One of your Federal Reserve colleagues, Governor Bowman, echoed some concerns in recent remarks when she said, "The unique nature and business models of the banks that have recently failed, in my view, do not justify imposing new and overly-complex regulatory and supervisory expectations on a broad range of banks.

"If we allow this to occur, we will end up with a system of significantly fewer banks serving significantly fewer customers. Those who will likely bear the burden of this new banking system are those at the lower end of the economic spectrum, both individuals and businesses."

Do you agree with her assessment?

Mr. BARR. I don't agree with that assessment. I think that capital in general is facilitating strong lending to all communities, and having strong capital in the system is critical for doing that.

Of course, for any changes that we propose, we are talking about the largest institutions in the country, institutions with over $100 billion in assets. The kinds of capital requirements that we are talking about are requirements that would help those firms better

account in their capital for their actual risk, such as making changes in the way unrealized losses and gains from securities are treated for capital purposes.

And the kinds of changes that we are talking about would be implemented after a formal notice-and-comment rulemaking and with appropriate——

Ms. DE LA CRUZ. I reclaim my time. How long has Governor Bowman served in this capacity?

Mr. BARR. I actually don't know when she arrived at the Board.

Ms. DE LA CRUZ. Okay. Let me move on to something else, because I am on a time crunch here.

In your assessment and in the report that you gave, you made a comment that supervisors recognized a gradual increase in liquidity and market risk, but they did not fully appreciate the risks associated with the concentrated deposit base or SVB's investment portfolio strategy.

Vice Chair Barr, what did you mean by, "did not fully appreciate?"

Mr. BARR. I think you can see from the findings of our report that supervisors saw, for example, the procedural problems with interest rate testing and liquidity testing but did not see fully the vulnerability of the firm as a whole. And that is an area in which I think we need to do better.

Ms. DE LA CRUZ. You said nobody has been fired for their lack of appreciation, is that correct?

Mr. BARR. Yes, at this time, nobody has been fired. As I mentioned, we are looking across our supervisory system to make sure that it is functioning well, and that we have the right tools at the supervisors' disposal.

Ms. DE LA CRUZ. Sure, I did hear that, and I thank you for your comment. I think, as a small business owner myself, when someone makes a mistake of this magnitude, we need to act quickly. And someone not fully appreciating the problem cost American taxpayers. It has put us all here today. And it is a situation where someone does need to be fired for their lack of appreciation.

With that, I yield back.

Chairman MCHENRY. The gentlelady yields back.

We have a vote series on the House Floor. That is two votes, PQ and Rule. We will take a brief recess until immediately following votes.

The committee stands in recess.

[recess]

Chairman MCHENRY. The committee will come to order. And I want to thank the panel for waiting, and I hope they were able to get a brief lunch break during that long vote series.

We will now go to Ms. Williams of Georgia for 5 minutes.

Ms. WILLIAMS OF GEORGIA. Thank you, Mr. Chairman.

And thank you to all of our witnesses here today.

It is not lost on me that on the other side of the Capitol, the executives of the failed Silicon Valley Bank and Signature Bank have been testifying before our colleagues in the Senate and sharing their different perspectives from the regulators before us today.

From my relatively short time in Congress, I have learned that conversations often happen in silos, while powerful stakeholders

point fingers and the most-marginalized become collateral damage. I hope today's hearing connects the dots and paints a more complete picture for my constituents and all Americans who are concerned about the stability of the banking sector.

Mr. Barr, the former CEO of SVB, Greg Becker, testified in the Senate that SVB's growth accelerated because of the government stimulus measures in response to the COVID-19 pandemic and near-zero interest rates designed to stimulate economic activity during the pandemic. Becker also pointed to the Fed's perceived signaling that they would keep rates low as the reason why his institution invested in U.S. Treasuries, which lost value when the Fed raised rates rapidly.

Essentially, Mr. Becker argued that the Fed's monetary response to the pandemic influenced the decisions SVB made, and those decisions were to blame for the sizable hole that developed on SVB's balance sheet.

As a Member of Congress who received text messages from constituents worried about meeting payroll on March 15th, I want to ensure that we don't lose sight of the impact that these failures have had and can still have on marginalized communities. We should thoroughly investigate this matter to understand what went wrong so that we can take steps to ensure that this does not happen again.

Mr. Barr, do you agree with Mr. Becker's assertions that the government's pandemic response and the Fed's monetary policy forced his bank to rapidly double in size? And if this were true, why didn't all other banks experience rapid asset growth and double in size?

Mr. BARR. Thank you very much for the question.

SVB's growth was significantly in excess of the sector's average over that time period. They grew dramatically for a wide variety of reasons, but the basic point is that as they were growing, they failed to manage their risks. They failed to manage interest rate risk. They failed to manage liquidity risk. Those are the obligations of the bank to undertake, and they failed to do that.

Ms. WILLIAMS OF GEORGIA. Others have raised concerns that two very important Fed functions, its monetary policymaking and its bank supervision, were not successfully communicating, which can have obvious implications for ordinary Americans who rely on a healthy banking system, especially when there is a crisis that ultimately disproportionately impacts vulnerable and marginalized consumers.

For example, the Fed conducted regular stress testing of the largest banks but rarely tested the rising interest rate environment that we have been in in the past year. Mr. Barr, what steps can the Fed take to better manage their dual responsibilities of bank regulation and monetary policy?

Mr. BARR. Thank you for that.

Obviously, when we are looking at monetary policy, we consider the economic impacts of bank stress. We anticipate, for example, that there will be additional credit tightening coming into the system. We take that into account with respect to monetary policy. And on the supervision side, supervisors are, of course, well aware and have been well aware since the fall of 2021 that we are and will be in a rising interest rate environment.

It is the responsibility of bank managers to take that circumstance into account in managing their interest rate risk. Supervisors did test for interest rate risk at Silicon Valley Bank. Silicon Valley Bank was failing its own internal stress test for interest rate risk, and rather than adequately mitigating that, they tried to change their test so it would be less conservative. They took off their interest rate hedges that would have helped to protect them somewhat from rising rates.

And so it is just, as I have said, a textbook case of bank mismanagement.

Ms. WILLIAMS OF GEORGIA. I want to zoom out and look at this a bit more broadly. Mr. Barr, how often and with what level of scrutiny does the Fed consider impacts of its supervisory and monetary decisions broadly on marginalized consumers and people of color?

Mr. BARR. We do take those considerations into account when thinking about our monetary policy. Obviously, there are differential unemployment effects, for example, in Black and Brown communities compared to White communities. But that is part of our thinking about how the economy is doing as a whole.

And similarly, with respect to supervision, particularly when we are looking at performance under the Community Reinvestment Act, we are looking at how well banks are serving low- and moderate-income communities.

Ms. WILLIAMS OF GEORGIA. Mr. Barr, and the rest of our witnesses, I am going to run out of time here, but in most hearings I bring up the fact that Atlanta is the City with the largest racial wealth gap in the country. And if you all are tired of hearing me talk about it, I can assure you that Black Atlantans are tired of living it.

So, I have more questions that I would very much like answers to in writing for the record.

Thank you so much, and I yield back, Mr. Chairman.

Chairman MCHENRY. I thank the gentlelady for yielding back. We will now recognize the gentleman from Tennessee, Mr. Ogles, for 5 minutes.

Mr. OGLES. Mr. Chairman, thank you.

And to our panelists, our guests, we appreciate you. I know it has been a long day. And obviously, it has been a tough few months.

Just jumping right in, Mr. Gruenberg, in remarks you made in March to the Institute of International Bankers, you noted that the banks had suffered unrealized losses to the tune of about $620 billion in their held-to-maturity assets. In your review of the FDIC's supervision of Signature Bank, did you find that the supervisors were aware of the unusual scale of the interest rate risk and the liquidity risk in the banking system?

Mr. GRUENBERG. Yes, Congressman. I think the report done by the Chief Risk Officer of the FDIC identified that the examiners were aware of the issues, and provided guidance and direction to the institution. And the report acknowledges that the institution was not timely or responsive.

I think the issue raised is when you have an institution, unlike most, that is not responsive to supervisory guidance and direction,

your supervisors need to take the next steps in order to compel compliance to deal with unsafe and unsound matters. And I think in this case that didn't happen, and I think that is perhaps the key finding of the report.

Mr. OGLES. Yes, sir. And then, Mr. Barr, same question as pertains to SVB. Were they aware of the unusual risk at hand?

Mr. BARR. Yes. The SVB report that we issued found that supervisors identified interest rate risk and liquidity risk that the bank was vulnerable to and conveyed to the firm the necessity of addressing those risks. The bank did not respond in a timely way, and supervisors did not escalate that matter quickly enough before the bank failed.

Mr. OGLES. And that is kind of the point that I want to hit on for the two of you. Is there anything in current regulation that would have prohibited the ability for supervisors to escalate and/or compel compliance?

Mr. BARR. No, they are not restricted under our current approach from doing that. I think the question is whether we can better design our supervisory system so that they have both the skills and the tools and the incentives to do that promptly.

Mr. OGLES. Mr. Gruenberg?

Mr. GRUENBERG. I agree with that, Congressman. Examiners had the authority. It was a matter of exercising it.

Mr. OGLES. Obviously, we have regulations, and we have rules. Is there anything in the rules that prohibited the escalation or the compliance?

Mr. BARR. With respect to our regulatory structure, the standards that supervisors were meant to apply to the firms changed as the firm grew. So in the early phases of its growth, the supervisory standards by our rules were lower. Those would have, in effect, delayed application of higher standards by about 3 years——

Mr. OGLES. Until they met that threshold, right?

Mr. BARR. I'm sorry?

Mr. OGLES. Until they met that threshold, that next level, right?

Mr. BARR. Until they met that threshold. And then, partly because of our rules, there was a transition period in the rules that was both complex and perhaps too long that made it difficult for supervisors and the bank to know precisely when they should meet that higher standard.

Mr. OGLES. And that is a great point. I think as we look at the regulatory structure, the rules between the—obviously, we are talking about California and New York, and I want to caution any request for further regulation or for further rulemaking when I think what we need to do is do a deep analysis of, how do we improve the current system?

I think I have said it once, and I will say it again, and I will probably use it over and over again: President Reagan cautioned that the scariest phrase in the English language is, "I am from the government, and I am here to help."

And oftentimes, when we take action or take action by rule, there are unintended consequences. We have a system in place, and you have two different agencies that, quite frankly, failed to escalate under the current environment, right? You have trillions of dollars going into the economy. You know that there is going to

be the risk of capital flight because of the change in the bond and interest rates. Where were the regulators? They were asleep at the wheel, quite frankly.

What can we do to create a culture and an environment—maybe, it is more training. I don't know what it is. That is your job, right? But I just want to say that you don't ask for more authority when, quite frankly, in my opinion, you didn't leverage the authority you had appropriately, and now we have this huge systemic loss amongst the top tier of our banking system, which is creating uncertainty amongst all the banks.

I have urban, suburban, and rural areas in my district, and my community banks are worried about what you all may do with that downward pressure, not to mention the whole tightening of the credit market.

Mr. Chairman, I yield back.

Mr. MEUSER. [presiding]. The gentleman yields back. The gentleman from Texas, Mr. Green, is now recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Mr. Chairman, I am just amazed at the language that I am hearing here today. We are an oversight committee for banks, and one would think that we are of the opinion that the way you perform oversight is to punish the regulator. I am just amazed that we should take actions to deter bankers from taking unreasonable risks and then walking away with the reward. That is what we should be doing.

Making speeches about regulatory overreach is not going to prevent this kind of unreasonable behavior. Talking about regulators being accountable won't do it, or firing regulators. There is no talk about firing bankers for unreasonable behavior. No talk about punishment for bankers for what they do to create the crisis.

Ultimately, the bankers were the people who committed the offense. They are the ones who are exposed to liability. The regulators have a job to do, but their job is not that of banking themselves. It is the bankers who have to be held accountable and liable. Regulators have no liability here.

I am just amazed. This whole hearing has been about maintaining the status quo, a status quo that has given us what we have today that is causing us to be here. Don't overreach. I don't know, is there a term, "underreach?" It seems as though we are proposing to make sure we underreach.

Don't do anything to create a means by which bankers might be punished. No talk about how will this committee work toward improving fines and regulations such that bankers can be punished for this kind of behavior.

The public wants to know what is going to happen to the bankers, the people who took this unreasonable risk. There is no evidence that anything will happen, if you listen to this body today. And these are my friends. I love them all, but they are wrong.

At some point, reality has to become a part of a hearing, and the reality is the bankers knew of the risk, didn't have risk management facility in place, made a lot of money by giving themselves bonuses at or near the time the bank failed, by the way, and they walked away. And they are probably out getting other jobs. There is no talk about what is going to happen to them.

I am just amazed. So, here is where I land on this. If we fail to do what is necessary to claw back this money that they received as bonuses at or near the time the bank failed, we will have done the public a disservice. We will have done banking a disservice. That is our job. We are not here to protect the bankers, to make sure that they get off scot-free.

It is time for us to do our job. Let me just simply ask this one question. The GAO official who was before us recently said as much, but I want to find out if you agree. He said, ultimately, at the end of the day, it is the bank that is responsible for what happened. At the end of the day, the bank is responsible for what happened.

And I would add that the bank is liable. Do you agree with this, that the banks are responsible for what happened? Since my time is about to expire, if you agree that the banks are responsible, just do this, extend a hand into the air, it doesn't matter whether it is your right or left hand.

[Show of hands.]

Mr. GREEN. Let the record reflect that all of the members of the panel extended a hand into the air.

The banks are responsible. And as responsible agents, they have to be put in check. That is our job, and I plan to do my job.

Mr. Chairman, I will yield back to you some 5 seconds.

Mr. MEUSER. The gentleman yields back. I now recognize myself for 5 minutes.

Thank you again, gentlemen.

Mr. Barr, may I ask you, do you feel the San Francisco Fed did a good job related to SVB?

Mr. BARR. The report that we released suggests that both the Board in Washington and the San Francisco Fed did not hold up the bank with enough pressure, did not force the bank to act with enough pressure to act quickly enough.

Mr. MEUSER. Okay. Did anyone at the bank or at the Fed—there is a lot of blame to be put on S. 2155. Do you think S. 2155 is to blame? And at the same time, isn't it true that when there are red flags waving like they were from SVB, the Fed has discretion to investigate further, regardless of S. 2155?

Mr. BARR. The 2018 law does give the Federal Reserve significant discretion to implement the law. And in the case of the 2019 tailoring rules that resulted, the report found that it did inhibit the Federal Reserve's ability to take action in a prompt enough way, and that is why we are looking at changing those rules. But we can do that within our existing authority.

Mr. MEUSER. You said two things. But the fact is that the Fed had discretion when you see significant problems taking place, regardless of S. 2155?

Mr. BARR. Yes, I agree with that, and the report finds as much.

Mr. MEUSER. And Mr. Barr, you also stated earlier how important it is to have a full range of banks—community, regional, super-regional, mega.

Mr. Gruenberg, do you agree with that?

Mr. GRUENBERG. I do, Congressman.

Mr. MEUSER. Okay. We are hearing even from some large banks that, "The problem with regional banks is that regulators think we are too-big-to-fail, but too-small-to-succeed."

What do you say about that statement, Mr. Gruenberg?

Mr. GRUENBERG. As a general matter, the regional bank sector in the United States is highly competitive and has done quite well and really fills a very important niche in the financial market. We have had issues with these institutions which are very serious, but as a general proposition, I think the regional banks are a source of strength for our banking system as a whole.

Mr. MEUSER. Do you feel the FDIC is doing much or doing anything to give regional banks equal treatment to the megabanks?

Mr. GRUENBERG. Yes. And if anything, I think the prudential requirements that apply to the so-called G-SIBs, or the largest institutions, on balance are a bit more stringent than on the regional institutions.

Mr. MEUSER. Okay. Regarding the special assessment proposed plan, I was reviewing it, and I have a couple of questions. We understand that under $5-billion bank deposits are exempt. Okay, that is very good. Community banks really appreciate that.

Let us say there is a regional bank—and I am just being hypothetical here—that has $205 billion in deposits. The new fee on top of the current fees is 12.5 basis points or 0.125. So, basically, that bank of $205 billion in deposits is now looking at a quarterly payment on 0.125 percent of $200 billion, which is $240 million.

The same bank, again, hypothetical, usually makes about 10 percent, so their net income is about $2.5 billion. So, this new assessment is nearly 10 percent of the net income of that hypothetical regional bank I just outlined. They are paying for SVB's malfeasance, First Republic's terrible mismanagement, and Signature, for whatever occurred there. That is a significant hit, nearly 10 percent of their annual net income.

Mr. GRUENBERG. I would have to go through the arithmetic of your example. I can tell you as a general proposition, we estimate that the special assessment will have a 1-quarter impact on earnings of the affected institutions on average of 17.5 percent, and then the payment would be stretched out over an 8-quarter period. So, the liquidity impact——

Mr. MEUSER. I have some questions there. First, did you get any feedback from the regionals as to something like, could they handle this? Second, why not an extended period of time as opposed to four quarters? And third, why not a graduated or progressive fee, which might be more fair?

Mr. GRUENBERG. One, this actually is a proposal, and we have put it out for public comment. So, there will be an opportunity for all banks to comment on the proposal, and we will get their feedback and that will be important. And then, the payment is stretched out actually over 8 quarters, over a 2-year period.

Mr. MEUSER. Okay. My time has expired.

The gentlewoman from Indiana, Mrs. Houchin, is now recognized for 5 minutes.

Mrs. HOUCHIN. Thank you, Mr. Chairman.

Vice Chairman Barr, companies across the country, including in southern Indiana, have been dealing with the inflationary effects

of rampant spending. When combined with supply chain issues and the lingering aftereffects of the pandemic, businesses are currently navigating what is already a fragile economy.

Given these realities, do you believe that increasing borrowing costs through higher capital requirements for regional banks is a good thing?

Mr. BARR. Thank you very much for the question.

We are talking about changes to our capital rules that would take many years to be fully effective. We are not looking to change capital rules tomorrow. We are talking about issuing a proposal, a notice for comment that would then lead to a final rule and a phase-in and implementation period. In general, strong capital requirements for banks leads to more lending throughout the cycle, not less.

Mrs. HOUCHIN. Have you taken any feedback or engaged with small business stakeholders to determine the impact on jobs and economic growth that your holistic review of capital will have?

Mr. BARR. Any rule that we propose would, of course, be a proposal, and then we would get feedback from the public, including if the small business community wanted to provide comment on that rule, we would be able to receive that comment and respond appropriately to it.

Mrs. HOUCHIN. Vice Chairman Barr, there are privately-insured credit unions in communities across the country, including in Indiana. While these financial institutions play an important role in their communities, they do not have access to the Fed's Bank Term Funding Program (BTFP) if they face an unexpected demand for deposit withdrawals. All financial institutions are susceptible to liquidity issues, but not all financial institutions are able to access this liquidity.

Mr. Barr, as my colleague asked you earlier, was there a reason why these institutions were left out of consideration for the Fed's BTFP?

Mr. BARR. At the time of the announcement, we were quite focused on federally-insured institutions and the stresses that they were under. We are not currently contemplating changing that facility at this time.

Mrs. HOUCHIN. My next question is, do you have plans to open access to BTFP to privately-insured credit unions? It sounds like you don't have any plans to do that. Why not?

Mr. BARR. Changing the facility would require a new determination, and we haven't seen evidence with respect to privately-insured credit unions that would justify that kind of movement at this time.

Mrs. HOUCHIN. Is it something you would consider if they faced the same types of liquidity issues we have seen?

Mr. BARR. I don't really want to get into hypotheticals about what the facts and circumstances might be.

Mrs. HOUCHIN. Chairman Gruenberg, last week the FDIC issued a proposed rule on the special assessment that was made necessary by the systemic risk exception for the SVB and Signature Bank failures. Would you provide insight on how the FDIC Board determined the parameters for this proposed special assessment to replenish the Deposit Insurance Fund?

Mr. GRUENBERG. Yes, Congresswoman, thanks for the question. The proposal was really developed by our Division of Insurance and Research at the FDIC, which is responsible for managing the Deposit Insurance Fund. And they developed the proposal, I think with a couple of things in mind.

Under the statute, we are required to impose a special assessment to make up for the cost to the Deposit Insurance Fund under the systemic risk exception, and we have the authority to target the special assessment on those institutions that benefitted the most from the systemic risk exception. The systemic risk exception was targeted on uninsured deposits. So, I think in crafting the special assessment, that was really the baseline. The institutions that had the most uninsured deposits would pay the most out. Although built into that was an exception for the first $5 billion of uninsured deposits, because it was pretty clear that community banks were really not part of the issue here. And as a general matter, they have a lower concentration of uninsured deposits.

So, that was really the framework that was then proposed to the board, and that we acted on.

Mrs. HOUCHIN. Thank you. I was certainly glad to see that smaller community banks, which had nothing to do with SVB or Signature Bank failures, were not on the hook for the failures of management or supervisors. Thank you for that. I encourage you to continue in that regard.

Quickly going back to Mr. Barr, on this issue of privately-insured credit unions, why are they being held to a different standard or provided with less opportunity than other institutions?

Mr. BARR. As I said, at the time the stress in the banking system that we were faced with was focused in federally-insured depositories.

Mrs. HOUCHIN. How are they different? My time is expiring.

Mr. HARPER. Congresswoman, if I could, just for one second? The Central Liquidity Facility at the NCUA is another option. Privately-insured credit unions are eligible at that facility, although I recognize that the Bank Term Funding Program has a better underwriting system simply because collateral is pledged at par as opposed to discounted for unrealized losses.

Mrs. HOUCHIN. Thank you. I would encourage you to allow the privately-insured credit unions to participate.

Thank you. I yield back.

Chairman MCHENRY. I want to thank the panel for being here today for a long day. I would encourage each of you, if you would, to please respond to Members' questions for the record in a timely fashion.

Mr. Barr, we are still waiting for your responses from the last hearing. As you know, I mentioned this on the phone call yesterday: With college, work begets more work. And if you get behind, it is tough to catch up. I want you to catch up.

But we commend you all for the responsiveness to our Members, and I want to thank all of you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these wit-

nesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And I would ask our witnesses to respond no later than June 16th.

I want to thank the panel again for your testimony, and this hearing is adjourned.

[Whereupon, at 2:54 p.m., the hearing was adjourned.]

A P P E N D I X

May 16, 2023

For release on delivery
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Statement by

Michael S. Barr

Vice Chair for Supervision

Board of Governors of the Federal Reserve System

before the

Financial Services Committee

U.S. House of Representatives

May 16, 2023

Chairman McHenry, Ranking Member Waters, and other members of the Committee, thank you for the opportunity to testify today. Overall, the U.S. banking system remains strong and resilient, and depositors should be confident that all deposits in our banking system are safe. At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks.

My review of Silicon Valley Bank's (SVB) failure demonstrates that there are weaknesses in regulation and supervision that must be addressed, and I am committed to doing so.[1] I am also committed to maintaining the strength and diversity of the banking system so that it can continue to provide financial services and access to credit for households and businesses. As we consider adjustments to our rules and supervisory practices, I am sensitive to how changes may affect banks in the current economic environment.

Accompanying my testimony today is the Federal Reserve's *Supervision and Regulation Report*. I am also submitting my report that examines the factors that led to the failure of SVB, including the role of the Federal Reserve. My testimony will offer an overview of banking conditions, the findings of the review, and opportunities for strengthening the Federal Reserve's regulatory and supervisory framework.

Banking Conditions

Let me begin with conditions in the banking system. Overall, banks have strong capital and liquidity, enabling them to lend and provide financial services to households and businesses.

At the same time, recent stress in the banking system shows the need for us to be vigilant as we assess and respond to risks. The recent failures of three large U.S. banks have also

[1] This testimony uses "Silicon Valley Bank (SVB)" to refer to both the state member bank, Silicon Valley Bank, and its bank holding company, SVB Financial Group.

demonstrated the risks of concentrated funding sources and poor management of interest rate risks. As interest rates have risen, fair values of investment securities have declined significantly. Deposit costs have also increased from low levels, and firms are turning to wholesale borrowings to address emerging funding needs. Delinquency rates for some loan segments have started to increase from the low levels seen over the past several years. Banks have increased provisions for credit losses in anticipation of asset quality deterioration. Accordingly, supervisors are redoubling their efforts to assess banks' preparedness for emerging credit, liquidity, and interest rate risks.

SVB Review

Let me turn to the SVB review. Immediately following SVB's failure, I led a review of the Federal Reserve's supervision and regulation of the bank. Staff who were not involved in the supervision of SVB conducted the review. The resulting report takes an unflinching look at the conditions that led to the bank's failure, including the role of Federal Reserve supervision and regulation. There are four key takeaways from the report.

First, SVB's board of directors and management failed to manage the bank's risks. The bank tripled in size between 2019 and 2021—expanding from $71 billion to $211 billion—as the rise in tech and venture capital activity led to growth in uninsured deposits, which the bank then invested largely in held-to-maturity securities. As the bank grew, its board and management failed to effectively oversee the risks inherent in the bank's concentrated business model and high level of reliance on uninsured deposits. The bank repeatedly failed its own liquidity tests, and SVB responded, in part, by changing the assumptions that determined its liquidity needs. The bank also mismanaged its interest-rate risk. Its senior leadership focused on short-term

profits, removed interest-rate hedges that would have helped to protect the bank in a rising rate environment, and ignored multiple breaches of long-term interest-rate-risk limits.

The second key takeaway is that Federal Reserve supervisors did not fully appreciate the extent of the vulnerabilities as SVB grew in size and complexity. This meant that SVB remained well-rated through the summer of 2022, even as significant risk to the bank's safety and soundness were growing.

The third key takeaway is that when supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that the bank fixed those problems quickly enough. When SVB became subject to heightened supervision in the large and foreign banking organization, or LFBO, portfolio in 2021, it was clear to supervisors that there were serious problems at the bank. However, Federal Reserve regulations provided SVB with a long runway to meet higher standards, and the bank entered the LFBO portfolio with a default view as satisfactory, which led examiners to wait to accumulate evidence to impose a lower rating. Yet supervisors found many serious problems: when the bank failed, it had 31 unaddressed safety and soundness supervisory findings—triple the number of peer banks. Overall, the supervisory approach at SVB was too focused on the continued accumulation of supporting evidence in an environment for supervision that emphasized consensus.

Finally, the fourth key takeaway is that the Federal Reserve Board's tailoring approach in response to the Economic Growth, Regulatory Relief, and Consumer Protection Act and a shift in the stance of supervisory policy impeded effective supervision by reducing standards, increasing complexity, and promoting a less assertive supervisory approach. Absent these changes, SVB would have been subject to supervision within the LFBO portfolio and subject to heightened standards beginning in 2019—throughout the bank's period of rapid growth. While

higher supervisory and regulatory requirements may not have prevented SVB's failure, they would have meant that the bank had stronger risk management and more financial resources to weather the stress.

The four key takeaways show failures by SVB's board and senior management and failures by the Federal Reserve. It is crucial that we address those failures. Next, I will outline how we can strengthen both our supervision and regulation based on what we have learned and based on the Federal Reserve's existing authorities. I highlight a few examples below.

Lessons Learned from SVB's Failure

To start, SVB's failure confirms the importance of strong levels of bank capital. While the proximate cause of SVB's failure was a liquidity run, the underlying issue was concern about its solvency—the bank's ability to absorb the losses on its securities and repay its depositors and other creditors. We should be humble about our ability—and that of bank managers—to predict how losses might be incurred, how future financial stress might unfold, and what the effect of financial stress might be on the financial system and our broader economy. Stronger capital will guard against the risks that we may not fully appreciate today and reduce the costs of bank failures.

A second key lesson is that SVB's distress proved to have broader consequences for the banking system, even though SVB was not extremely large, highly connected to other financial counterparties, or involved in critical financial services. We need to reconsider the requirements that apply to banks based on size and risk.

With respect to capital, we need to evaluate whether our capital requirements appropriately measure the ability of banks to absorb losses. Had SVB been required to reflect declines in the face value of available-for-sale securities in its capital, it may have held more

capital to cover these losses. Any rule changes such as these that we might propose would not be effective for several years because of the standard notice and comment rulemaking process and would be accompanied by an appropriate phase-in.

We also should evaluate how we supervise and regulate a bank's management of interest-rate risk. While interest-rate risk is a core risk of banking that is not new to banks or supervisors, SVB did not appropriately manage its interest-rate risk, and supervisors did not force the bank to fix these issues quickly enough.

In addition, we should evaluate how we supervise and regulate liquidity risk, starting with the risks of uninsured deposits. For instance, liquidity requirements and models used by both banks and supervisors should better capture the liquidity risk of a firm's uninsured deposit base. We should also consider applying standardized liquidity requirements to a broader set of banks. Any adjustments to our rules would, of course, go through normal notice and comment rulemaking and have appropriate transition periods.

In addition, our oversight of incentive compensation for bank managers should also be improved. SVB's senior management responded to the poor incentives approved by its board of directors; they were not compensated to manage the bank's risk, and they did not do so effectively.

Speed, Force, and Agility of Supervision

I also plan to improve the speed, force, and agility of supervision. Supervisors did not fully appreciate the extent of the vulnerabilities as SVB grew in size and complexity, and when supervisors did identify vulnerabilities, they did not take sufficient steps to ensure that SVB fixed those problems quickly enough.

Supervision should intensify at the right pace as a bank grows in size or complexity. Within our supervisory structure, there should be more continuity between the portfolios for banks of different sizes and risk so that a bank is ready to comply with heightened regulatory and supervisory standards more quickly. We also need to be especially attentive to the particular risks that banks with rapid growth, concentrated business models, or other special factors might pose regardless of asset size.

Once identified, issues should be addressed more quickly, both by the bank and by supervisors. Today, for example, the Federal Reserve generally does not require additional capital or liquidity beyond regulatory requirements for a bank with inadequate capital planning, liquidity risk management, or governance and controls. I believe that needs to change in appropriate cases. Higher capital or liquidity requirements can serve as an important safeguard until risk controls improve, and they can focus management's attention on the most critical issues.

Moreover, we need to ensure we have a culture that empowers supervisors to act in the face of uncertainty. Supervisors should be encouraged to evaluate risks with rigor and consider a range of potential shocks and vulnerabilities so that they think through the implications of tail events with severe consequences.

Conclusion

I want to reiterate that the banking system remains strong and resilient. Recent events demonstrate that we—as regulators—must do better. We need to ensure that we have strong supervision and regulation to make the financial system safer and fairer, in support of an economy that serves the needs of households and businesses.

Thank you, and I look forward to your questions.

STATEMENT BY

MARTIN J. GRUENBERG
CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

"Oversight of Prudential Regulators"

before the

COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

May 16, 2023
2128 Rayburn House Office Building
Washington, DC

Chairman McHenry, Ranking Member Waters, and Members of the Committee, I am pleased to appear at today's hearing on "Oversight of Prudential Regulators," to discuss the condition of the banking industry and the Deposit Insurance Fund (DIF), provide the Committee with an update on the Federal Deposit Insurance Corporation's (FDIC) resolution of three recently closed insured depository institutions, and share the results of two recently released reports, *The FDIC's Supervision of Signature Bank* and *Options for Deposit Insurance Reform*. Additionally, my testimony will discuss the agency's rulemaking agenda for the coming year, including the Notice of Proposed Rulemaking (NPR) issued last week providing for the Special Assessment required by law to recover the loss to the DIF arising from actions taken in March to resolve Silicon Valley Bank (SVB), Santa Clara, California, and Signature Bank, New York, New York.[1]

State of the Banking Industry

The banking industry has proven to be quite resilient during this period of stress. Early reports from first quarter 2023 indicate that first quarter aggregate bank net income was roughly unchanged compared to the fourth quarter, excluding the effects on acquirers' incomes of their acquisitions of failing banks. In addition, asset quality metrics remain favorable, and the industry remains well capitalized. Recent declines in medium- and long-term rates have reduced somewhat the volume of unrealized losses on securities.

Risks to the outlook include the potential for weakening credit quality and profitability that could result in further tightening of loan underwriting, slower loan growth and higher provision expenses. Commercial real estate (CRE) loan portfolios, particularly loans backed by office properties, face challenges should demand for office space remain weak and property

[1] 12 U.S.C. § 1823(c)(4)(G)(ii).

values continue to soften. Higher interest rates and reduced property values may contribute to increased financing costs and make refinancing CRE loans more difficult.

Notably, the recent banking turmoil exacerbated deposit movement to other deposit accounts or non-deposit alternatives outside of the banking system[2] and accelerated an already developing trend of increasing deposit costs seen in the 46 basis point increase between the third and fourth quarters of 2022. While the FDIC Quarterly Banking Profile data will not be available until later this month, early reports from first quarter 2023 indicate that deposit costs have risen more than asset yields, which may result in a tightening of net interest margin for some banks.

Securities and other assets with longer maturities and lower yields may hinder earnings and adversely affect bank balance sheets in coming quarters, further limiting the ability of banks to lend, raise capital, or restructure. Banks with high levels of mortgages may be particularly impacted, as these loans, even commercial mortgages, tend to have at least certain periods where payments are made based on fixed rates. As noted above, recent declines in medium and long-term rates have reduced somewhat the volume of unrealized losses on securities.

The economy slowed in recent months in part from higher interest rates and inflation, and the outlook for 2023 weakened in March. Stress in the banking system may reduce credit availability and slow economic growth. Credit tightening is likely to be most prominent in banks that experienced the largest deposit outflows during the banking turmoil, although the banking industry in aggregate could tighten lending as a reaction to general liquidity concerns. Early reports from first quarter 2023 indicate some slowdown in quarterly loan growth as deposit

[2] Balances at institutional Treasury and Government MMMFs surged by 11% to $2.9tn in March 2023 after March 12, 2023.

outflows have continued. Banks have already begun to tighten underwriting standards over the past year across a range of household and business loans, and they tightened further in the first quarter of this year.[3]

The FDIC will continue to examine prevailing trends in the banking industry and will publicly release data for the first quarter of this year as part of the Quarterly Banking Profile.

Liquidity Monitoring

Over the past two months, the FDIC has continued to closely monitor liquidity, including deposit trends, across the banking industry. Overall, liquid assets in the banking industry remain higher than pre-pandemic levels, though they have been declining since mid-2021. Following the decision to fully protect all depositors in the resolution of both SVB and Signature Bank, there has been a moderation of deposit outflows at the publicly traded banks that were experiencing large outflows in the immediate aftermath of those failures. In general, banks have taken steps to increase liquidity and build liquidity buffers, including through borrowings secured by securities and loans. In the weeks immediately following these two failures, banks initiated new Federal Home Loan Bank (FHLB) advances to strengthen liquidity and also pre-positioned additional collateral at the FHLB to support future draws, if needed. Banks also accessed the Federal Reserve Board's (Federal Reserve) Discount Window, with borrowings increasing sharply from approximately $5 billion on March 8 to nearly $153 billion on March 15, before declining to $5 billion as of May 3. Additionally, banks utilized the Federal Reserve's

[3] Federal Reserve Senior Loan Officer Opinion Survey on Bank Lending Practices, April 2023. https://www.federalreserve.gov/data/sloos/sloos-202304.htm

new Bank Term Funding Program (BTFP),[4] with borrowings during April through May 3 remaining near the peak of $81 billion reached on April 26, 2023.[5]

Condition of the Deposit Insurance Fund

As of December 31, 2022, the Deposit Insurance Fund (DIF) balance totaled $128.2 billion, up $5.1 billion (4.1 percent) from one year earlier while annual insured deposit growth was 3.3 percent. Slower insured deposit growth in relation to the growth in the DIF balance resulted in the reserve ratio increasing by 1 basis point from 1.26 percent as of December 31, 2021 to 1.27 percent as of December 31, 2022.[6]

As required by the Federal Deposit Insurance Act (FDI Act),[7] the FDIC has been operating under a Restoration Plan since September 15, 2020,[8] when extraordinary growth in insured deposits that occurred during the first half of 2020 resulting from actions taken in response to the COVID-19 pandemic caused the DIF reserve ratio to decline below the statutory minimum of 1.35 percent as of June 30, 2020. The Restoration Plan aims to restore the DIF to the statutory minimum of 1.35 percent within the eight-year deadline required by statute, or by September 30, 2028.

On June 21, 2022, based on projections that the reserve ratio was at risk of not reaching the statutory minimum of 1.35 percent by September 30, 2028, the Board amended the

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[4] The BTFP provides qualified institutions with eligible securities the ability to access longer term (one year) funding at par, which should alleviate the need to sell those securities at a loss in times of stress, as happened at Silvergate Bank and SVB. For more information, see https://www.federalreserve.gov/monetarypolicy/bank-term-funding-program.htm.

[5] Federal Reserve Statistical Release, H.4.1 Factors Affecting Reserve Balances, March 9, 2023, through May 4, 2023. Factors Affecting Reserve Balances of Depository Institutions. https://www.federalreserve.gov/releases/h41/.

[6] The reserve ratio is calculated as the ratio of the net worth of the DIF (fund balance) to the value of the aggregate estimated insured deposits at the end of a given quarter. See 12 U.S.C. 1813(y)(3).

[7] Section 7(b)(3)(E) of the Federal Deposit Insurance Act, 12 USC 1817(b)(3)(E), available at https://www.fdic.gov/regulations/laws/rules/1000-800.html#fdic1000sec.7b.

[8] 2020 FDIC Restoration Plan, 85 FR 59306 (Sept. 21, 2020), available at https://www.fdic.gov/news/board-matters/2020/2020-09-15-notice-dis-a-fr.pdf.

Restoration Plan. In conjunction with the Amended Restoration Plan, the Board proposed, and subsequently finalized, an increase in initial base deposit insurance assessment rate schedules of 2 basis points, to improve the likelihood that the reserve ratio would be restored to at least 1.35 percent by September 30, 2028.[9] The revised assessment rate schedules became effective January 1, 2023, and are applicable to the first quarterly assessment period of 2023.

The FDIC estimated the cost to the DIF for the failures of SVB and Signature Bank to be $16.1 billion and $2.4 billion, respectively.[10] Of that estimated total cost of $18.5 billion, the FDIC estimated that approximately $15.8 billion was attributable to the cost of covering uninsured deposits as a result of the systemic risk determination made on March 12, 2023, following the closures of SVB and Signature Bank.[11] By statute, the FDIC is required to recover the $15.8 billion estimated loss through one or more special assessments. Accordingly, the FDIC initiated a notice of proposed rulemaking to establish this special assessment, as described later in this testimony.

The remaining estimated loss from the failures of SVB and Signature Bank of $2.7 billion, and an additional $13 billion in loss from the subsequent closure of First Republic Bank, for which no systemic risk determination was made, will directly impact the DIF. As with all

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[9] 2022 FDIC Amended Restoration Plan, 87 FR 39518 (July 1, 2022), available at https://www.fdic.gov/news/board-matters/2022/2022-06-21-notice-sum-b-fr.pdf. Notice of Proposed Rulemaking on Assessments, Revised Deposit Insurance Assessment Rates, 87 FR 39388 (July 1, 2020), available at https://www.fdic.gov/news/board-matters/2022/2022-06-21-notice-dis-a-fr.pdf.

[10] See FDIC: PR-21-2023 3/19/2023 and FDIC: PR-23-2023 3/26/2023.

[11] The cost estimate for the sale of the Silicon Valley Bridge Bank to First-Citizens Bank & Trust Company has been revised from the original estimate of $20.0 billion to approximately $16.1 billion, due to a decrease in the amount of liabilities assumed by First Citizens relative to the initial estimate, higher anticipated recoveries from certain other assets in receivership, and an increase in the market value of receivership securities. This revised cost estimate forms the basis for the SVB portion of the current special assessment calculation, and, as with all failed bank receiverships, will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred.

failed bank receiverships, loss estimates will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred.

As required under the Restoration Plan, the FDIC continues to monitor potential losses, deposit balance trends, and other factors that affect the reserve ratio, and will continue to update projections for the DIF balance and reserve ratio at least semiannually while the Restoration Plan is in effect. In the next update, the FDIC will provide clarity on how losses from past bank failures and reserves related to future bank failures will have affected the reserve ratio. At this time, no further adjustments to assessments are contemplated and the DIF remains on track to meet the statutory reserve ratio by September 30, 2028.

Recent Bank Failures

On March 8, 2023, SVB announced that it sold securities at a loss to meet deposit withdrawals that had been occurring since the second quarter of 2022 and planned to raise capital.[12] The same afternoon, Silvergate Bank, La Jolla, California (Silvergate) announced its intent to self-liquidate[13] after similarly selling securities at a loss to meet depositor withdrawals. These events prompted a deposit run on SVB.[14] SVB had a high level of uninsured deposits, at 94 percent of domestic deposits at year-end 2022, and a concentrated and connected customer base that fueled the run through social media. It is now known that in a period of less than 24 hours, depositors withdrew or sought to withdraw nearly all of the SVB's deposits prior to its

[12] See SVB Financial Group Form 8-K (March 8, 2023), available at https://www.sec.gov/ix?doc=/Archives/edgar/data/719739/000119312523064680/d430920d8k.htm.
[13] See Silvergate Capital Corporation Press Release, *Silvergate Capital Corporation Announces Intent to Wind Down Operations and Voluntarily Liquidate Silvergate Bank* (March 8, 2023), available at https://ir.silvergate.com/news/news-details/2023/Silvergate-Capital-Corporation-Announces-Intent-to-Wind-Down-Operations-and-Voluntarily-Liquidate-Silvergate-Bank/default.aspx.
[14] See *New York Times*, "Silicon Valley Bank's Financial Stability Worries Investors" (March 9, 2023), available at https://www.nytimes.com/2023/03/09/business/silicon-valley-bank-investors-worry.html.

closure by the California Department of Financial Protection and Innovation (CADFPI) on March 10, 2023.

Contagion effects from SVB's failure began to spread through traditional media, social media, and short sellers to other banks with perceived similar risk characteristics, notably, those with high levels of uninsured deposits, concentrations of customers in the venture capital and tech industries, and high levels of unrealized losses on securities. Contagion effects initially manifested in large declines in stock prices and then in deposit outflows at certain other banks. For two of these banks – Signature Bank and First Republic Bank, San Francisco, California (First Republic Bank) – deposit outflows became deposit runs and exposed other weaknesses that could not be overcome, leading to their failure. For Signature Bank, poor governance and inadequate risk management practices put it in a position where it could not effectively manage its liquidity in a time of stress, making it unable to meet very large withdrawal requests. While First Republic Bank was initially able to manage liquidity to meet withdrawal requests, management's strategic decision to retain a long-standing business model with a significant asset/liability mismatch during a period of rising interest rates contributed to a loss of confidence in the bank on the part of depositors, and, ultimately constrained options for the bank to restructure its balance sheet, sell assets, or raise capital.

First Republic Bank highlighted a related risk characteristic to unrealized losses on securities, namely the difference between the fair value and amortized cost[15] of loans. The amortized cost and fair value of securities, which provide the data to determine related unrealized losses, are readily available and reported quarterly on all insured institutions'

[15] The amortized cost basis is the amount at which a financing receivable or investment is originated or acquired, adjusted for applicable accrued interest, accretion, or amortization of premium, discount and net deferred fees or costs, collection of cash, write-offs, foreign exchange, and fair hedge accounting adjustments.

Consolidated Reports of Condition and Income (Call Report).[16] In accordance with U.S. Generally Accepted Accounting Principles (GAAP), publicly traded banks and bank holding companies include fair value measurement disclosures on appropriate classes of assets and liabilities, which may include loans, in the notes to consolidated financial statements,[17] but they are not required to report loans intended to be held for investment at fair value on their financial statements or Call Report. Unlike SVB, First Republic Bank's unrealized losses on its securities portfolio did not exceed its capital, per its Call Report, it was not experiencing deposit withdrawals, and it did not sell assets at a loss to meet withdrawals. Nonetheless, the bank's long-dated and low yielding loan portfolio resulted in a large difference between the amortized cost and fair value of the bank's loans.[18]

At least beginning on March 10, 2023,[19] reports began to highlight, and social media and short seller forums began to amplify, banks and bank holding companies with high levels of uninsured deposits that also had notable differences between the fair value of loans reported in public financial statements and the loans' amortized cost, including First Republic.

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[16] See Call Report Schedule RC-B, Securities.

[17] The Financial Accounting Standards Board Accounting Standards Codification (ASC) addresses fair value. ASC Topic 820, Fair Value Measurement, defines fair value, establishes a framework for measuring fair value, and addresses financial statement disclosures about fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants in the asset's or liability's principal (or most advantageous) market at the measurement date. This value is often referred to as an "exit" price.

[18] The amortized cost basis, net of allowances for credit losses, exceeded the fair value by $22 billion on real estate secured mortgage loans and other loans as of December 31, 2022. See Form 10-K, February 28, 2023, https://ir.firstrepublic.com/static-files/89a1df66-7e28-4491-86aa-a331900db222. The difference between amortized cost (net of allowances for credit losses) and fair value is not reported on the balance sheet or income statement and does not reduce equity capital in accordance with U.S. generally accepted accounting principles. With regard to held for investment loans reported at amortized cost, disclosed changes in fair values that are not included in the balance sheet or income statement are also not included in regulatory capital.

[19] See "Monetary Tightening and U.S. Bank Fragility in 2023, Mark-to-Market Losses and Uninsured Depositor Runs?" Erica Jiang, Gregor Matvos, Tomasz Piskorski, and Amit Seru, first published March 13, 2023 at https://www.nber.org/papers/w31048 and "First Republic Hit by SVB Failure, Investors have Grown Wary of First Republic Bank for Reasons Similar to Those that Caused Concern at SVB," Jonathan Weil, Wall Street Journal, March 10, 2023 at https://www.wsj.com/articles/first-republic-hit-by-svb-failure-7431495e.

First Republic Bank Closing

First Republic Bank was established on July 1, 1985. The bank focused on offering banking services to high-net-worth individuals, including residential real estate lending, private banking, business banking, wealth management, trust, and brokerage services. As of March 31, 2023, the bank had total assets of $232.9 billion and total deposits of $104.5 billion, of which, approximately 48 percent were uninsured, and total wealth management assets under management or administration of $271 billion.

On the day the run on SVB began, March 9, 2023, the bank received a material net inflow of deposits, likely some of which was from SVB customers, as both were headquartered in San Francisco. While the bank did not have a venture capital business line featuring commercial loans to startups of various phases, by virtue of its market and business model, it served customers employed in and related to the venture capital and tech industries. On March 10, however, with the failure of SVB, the deposit trend reversed and the bank began experiencing significant deposit outflows due to contagion effects from SVB and subsequent wider-spread stresses at regional banks with higher levels of uninsured deposits. The bank's level of uninsured deposits to total deposits was 68 percent at year-end 2022. On March 10, First Republic Bank's share price, as with certain other banks, declined by over 50 percent intraday in the wake of significant negative short seller and social media attention, with trading halted several times. Deposit outflows reached approximately $25 billion at the end of the day, or approximately 17 percent of total deposits, requiring significant draws on the bank's Federal Home Loan Bank and Federal Reserve lines. The bank received additional liquidity through the Federal Reserve's Discount Window on Sunday, March 12.

On Monday, March 13, after the subsequent failure of Signature Bank on March 12 and announcement of the Systemic Risk Determination, which among other things, protected all uninsured depositors at the two failed banks, negative short seller and social media attention continued and accelerated, resulting in an additional 62 percent decline in the bank's stock price; trading was again halted several times. Depositor withdrawal demands were significant, with approximately $40 billion in deposit outflows on March 13. Outflows continued that week, albeit at somewhat of a lesser pace. On March 16, 2023, a consortium of 11 major U.S. banks placed $30 billion in uninsured deposits at First Republic Bank to reflect confidence and support in the bank and overall banking sector and in an effort to help stem the contagion effect of the SVB and Signature Bank failures to the wider banking system.[20] With the $30 billion in consortium deposits, withdrawals slowed, and then stabilized during the week ending March 24. The bank began working with outside firms on March 15 to raise capital and implement steps to restructure its balance sheet and business model, which now reflected significant reliance on more costly borrowings to replace lost deposits.

On April 24, 2023, the bank reported its financial results for the first quarter of 2023. The disclosure of a significant loss of deposits prompted a negative market response, a significant decline in the bank's stock price and a resumption of deposit outflows of more than $10 billion between Wednesday, April 26 and Friday, April 28, 2023. Given the further deterioration in the bank's condition with the additional deposit loss, and the lack of progress and prospects for improving the bank's condition, the FDIC and CADFPI downgraded the bank to

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[20] JPMorgan Chase & Co., Citigroup Inc., Bank of America Corp., and Wells Fargo & Co. each made a $5 billion uninsured deposit, Morgan Stanley and Goldman Sachs Group Inc. contributed $2.5 billion each, and U.S. Bancorp, PNC Financial Services Group Inc., Truist Financial Corp., Bank of New York Mellon Corp., and State Street Corp contributed $1 billion each. https://www.businesswire.com/news/home/20230316005695/en/.

problem status on April 28, 2023. The downgrade shifted the bank's borrowing status with the Federal Reserve to Secondary Credit, which eliminated remaining capacity to meet liquidity demands due to additional collateral haircuts.

On May 1, 2023, First Republic Bank was closed by the CADFPI, which simultaneously appointed the FDIC as receiver. The FDIC entered into a purchase and assumption agreement with JPMorgan Chase Bank, National Association, Columbus, Ohio (JPMC) to assume all of the deposits and substantially all of the assets of First Republic.[21] As part of the transaction, First Republic Bank's 84 offices in eight states reopened that same morning as branches of JPMC. All depositors of First Republic Bank became depositors of JPMC.

During the week of April 24, 2023, a small number of institutions contacted the FDIC to express their interest in acquiring First Republic Bank should it be placed into receivership. On April 27, 2023, the FDIC engaged with these institutions to better understand the nature of their interest, and subsequently requested indicative bids from these institutions by 5:00 P.M. on April 28, 2023 to gauge the strength of the market for the bank and prepare for a formal marketing process. The formal marketing process was then initiated on the evening of April 28, 2023, with a bid deadline of April 30, 2023 at 12:00 P.M. The FDIC invited 21 banks and 21 nonbanks to participate in the bidding process, and received 12 bids from four bidders. As a result of the competitive first round of bidding, the FDIC requested best and final offers from the four bidders by 7:00 P.M. on April 30, 2023. The resolution of First Republic Bank involved a highly competitive bidding process that resulted in a transaction that clearly represented the least cost

[21] See *JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All the Deposits of First Republic Bank, San Francisco, California*, FDIC: PR-34-2023, (May 1, 2023), available at: https://www.fdic.gov/news/press-releases/2023/pr23034.html.

option to the DIF, was consistent with the least cost requirements of the FDI Act, and could be pursued upon the closure of the bank.

As part of the transaction, the FDIC and JPMC entered into a loss-share agreement on the single-family mortgage and commercial loan portfolios it purchased of First Republic Bank. The FDIC and JPMC will share in the losses and potential recoveries on the loans covered by the loss-share agreement, which is projected to maximize recoveries on the assets by keeping them in the private sector. In addition, JPMC also assumed all Qualified Financial Contracts.

The FDIC estimates that the cost to the DIF will be $13 billion. This initial loss estimate is subject to further revision, and the final cost will be determined when the FDIC terminates the receivership.

Silicon Valley Bank Receivership

On March 26, 2023, the FDIC approved First-Citizens Bank & Trust Company (First Citizens), Raleigh, North Carolina, as the successful bidder to assume all deposits and loans of Silicon Valley Bridge Bank (SV Bridge Bank). First Citizens also acquired the bank's private wealth management business. The 17 former branches of SV Bridge Bank in California and Massachusetts reopened as First Citizens branches on March 27.

As of March 10, 2023, SV Bridge Bank had approximately $167 billion in total assets and approximately $119 billion in total deposits. The transaction with First Citizens included the purchase of about $72 billion of SV Bridge Bank's assets at a discount of $16.5 billion. Approximately $87 billion in securities and other assets were retained by the receivership for later disposition by the FDIC. In addition, the FDIC received equity appreciation rights in First Citizens BancShares, Inc. common stock, which were exercised on March 28, 2023, and sold on April 4, 2023, at a total return of $500 million.

At SVB, for which 88 percent of domestic deposits were uninsured at the point of failure, the portion of the total estimated loss of $16.1 billion that is attributable to the protection of uninsured depositors is $14.2 billion. The cost estimate for the sale of the SV Bridge Bank to First Citizens has been revised from the original estimate of $20.0 billion to approximately $16.1 billion, due to a decrease in the amount of liabilities assumed by First Citizens relative to the initial estimate, higher anticipated recoveries from certain other assets in receivership, and an increase in the market value of receivership securities. This revised cost estimate forms the basis for the SVB portion of the current special assessment calculation, and, as with all failed bank receiverships, will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred. As noted below, the amount of the special assessment will be adjusted as the loss estimate is refined over time.

The FDIC is currently undertaking a marketing process to sell the $87 billion securities portfolio of the former SVB that was retained in the receivership. The securities are primarily comprised of Agency Mortgage Backed Securities, Collateralized Mortgage Obligations, and Commercial Mortgage Backed Securities. On April 5, 2023, the FDIC announced that it had retained BlackRock Financial Market Advisory, pursuant to a competitive bidding process, to conduct portfolio sales, which will be gradual and orderly, and will aim to minimize the potential for any adverse impact on market functioning by taking into account daily liquidity and trading conditions.[22]

[22] See *FDIC Announces Retention of Financial Advisor to Assist with the Liquidation of Securities of the Former Signature Bank, New York, NY, and Silicon Valley Bank, Santa Clara, CA*, FDIC: PR-29-2023 (April 5, 2023), available at: https://www.fdic.gov/news/press-releases/2023/pr23029.html.

Signature Bank Receivership

On March 19, 2023, the FDIC board approved a purchase and assumption agreement for the acquisition of substantially all deposits and certain loan portfolios of Signature Bridge Bank by Flagstar Bank, N.A. (Flagstar Bank), a subsidiary of New York Community Bancorp, Inc. The 40 former branches of Signature Bank began operating under Flagstar Bank on Monday, March 20, 2023. Depositors of Signature Bridge Bank, other than those whose deposits were not assumed by Flagstar Bank, automatically became depositors of the acquiring institution.

As of December 31, 2022, Signature Bank had total deposits of $88.6 billion and total assets of $110.4 billion. The transaction with Flagstar Bank included the purchase of about $38.4 billion of Signature Bridge Bank's assets, including loans of $12.9 billion purchased at a discount of $2.7 billion. Approximately $60 billion in loans and $27 billion in securities were retained by the receivership for later disposition by the FDIC. In addition, the FDIC received equity appreciation rights of up to $300 million in New York Community Bancorp, Inc. common stock, which were exercised on March 21, 2023. The FDIC is retaining an underwriter to assist in liquidating the shares received under this transaction and expects to do so this month.

Flagstar Bank assumed most of Signature Bank's deposits, but did not seek to acquire approximately $4 billion of deposits related to Signature Bank's digital-assets banking business. On Saturday, March 25, the FDIC notified those depositors that Flagstar had not assumed their deposits and requested that they contact Flagstar Bank, who served as FDIC's paying agent, to obtain their deposits and facilitate closing their account by April 5, 2023.

The FDIC estimates the cost of the failure of Signature Bank to the DIF to be approximately $2.4 billion. At Signature Bank, for which 67 percent of deposits were uninsured at the point of failure, the portion of the total estimated loss of $2.4 billion that is attributable to

the protection of uninsured depositors is $1.6 billion. As with all failed bank receiverships, this estimate will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred. As noted below, the amount of the special assessment related to the loss associated with the coverage of Signature's uninsured deposits will be adjusted as the loss estimate is refined over time.

As with the securities retained from the SVB receivership, the FDIC has undertaken a marketing process to sell the $27 billion securities portfolio of Signature Bank. The securities are primarily comprised of Agency Mortgage Backed Securities, Collateralized Mortgage Obligations, and Commercial Mortgage Backed Securities. BlackRock Financial Market Advisory will also conduct this portfolio sale.[23]

On April 3, 2023, the FDIC announced the framework of a marketing process for the approximately $60 billion loan portfolio retained in receivership following the failure of Signature Bank.[24] The portfolio is comprised primarily of CRE loans, commercial loans and a smaller pool of single-family residential loans. The CRE loans include a concentration of multifamily properties, primarily located in New York City.

The FDIC has a statutory obligation, among other factors, to maximize the preservation of the availability and affordability of residential real property for low- and moderate-income individuals.[25] The FDIC is currently reviewing the CRE loans secured by multifamily residences that are rent stabilized or rent controlled, both of which are important sources of affordable housing in New York City. The FDIC is committed to engaging with state and local government

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[23] See *FDIC Announces Retention of Financial Advisor to Assist with the Liquidation of Securities of the Former Signature Bank, New York, NY, and Silicon Valley Bank, Santa Clara, CA*, FDIC: PR-29-2023 (April 5, 2023), available at: https://www.fdic.gov/news/press-releases/2023/pr23029.html.

[24] See *FDIC Announces Upcoming Sale of the Loan Portfolio from the Former Signature Bank, New York, New York*, FDIC: PR-26-2023 (April 3, 2023), available at: https://www.fdic.gov/news/press-releases/2023/pr23026.html.

[25] 12 U.S.C. § 1823(d)(3)(D)(v).

agencies, as well as community-based organizations, to seek their input as the FDIC develops its marketing and disposition strategy. The FDIC expects to begin its marketing of the retained loan portfolio of former Signature Bank later this summer. Newmark & Company Real Estate, Inc. has been retained as an advisor on this sale.

The FDIC has also retained Signature Bank's interest in the Signet platform, a blockchain-based digital payments platform, in the receivership. The FDIC has evaluated the intellectual property, third-party service contracts, and owned technology, which together make up the Signet platform and will begin to competitively market these assets shortly.

Internal Review of the FDIC's Supervision of Signature Bank

Following the failure of Signature Bank, the FDIC's Chief Risk Officer conducted, at my request, an internal review of the cause of failure and evaluation of the FDIC's supervision of the bank. The Chief Risk Officer is independent of the Division of Risk Management Supervision, which was responsible for the oversight of Signature Bank. The results of this review were released on April 28, 2023.[26] The review identified several matters for further study – including reinforcing the FDIC's forward-looking supervision philosophy and the importance of addressing risk management weaknesses before financial decline occurs; considering the need for enhanced examination guidance for supervising banks that are overly reliant on uninsured deposits and for assessing liquidity risk management practices; continuing to evaluate the continuous examination process and to implement necessary changes; and evaluating, and escalation processes for situations involving repeat recommendations, among others.

[26] See *FDIC Releases Report Detailing Supervision of the Former Signature Bank, New York, New York*, FDIC: PR-33-2023 (April 28, 2023), available at: https://www.fdic.gov/news/press-releases/2023/pr23033.html.

Causes of Failure and Material Loss

The report of the FDIC Chief Risk Officer found that the primary cause of Signature Bank's failure was illiquidity precipitated by contagion effects in the wake of the announced self-liquidation of Silvergate, on March 8, 2023, and the failure of SVB, on March 10, 2023, after both experienced deposit runs. However, the root cause of Signature Bank's failure was poor management. According to the Chief Risk Officer, Signature Bank's board of directors and management pursued rapid, unrestrained growth without developing and maintaining adequate risk management practices and controls appropriate for the size, complexity and risk profile of the institution. Bank management did not prioritize good corporate governance practices, did not always heed FDIC examiner concerns, and was not always responsive or timely in addressing FDIC supervisory recommendations.

Signature Bank funded its rapid growth through an overreliance on uninsured deposits without implementing fundamental liquidity risk management practices and controls. Additionally, the bank failed to understand the risk of its association with, and reliance on, crypto industry deposits or its vulnerability to contagion from crypto industry turmoil that occurred in late 2022 and into 2023. Although fallout from the liquidation of Silvergate and the failure of SVB was unprecedented and unfolded rapidly, Signature Bank's poor governance and inadequate risk management practices put the bank in a position where it could not effectively manage its liquidity in a time of stress, making it unable to meet very large withdrawal requests.

The FDIC's Supervision of Signature Bank

While the report of the FDIC Chief Risk Officer identified the root cause of Signature Bank's failure as poor management, it also identified areas where the FDIC's supervisory efforts could have been more timely, forward looking, and forceful. Specifically, the report found that it

would have been prudent to downgrade the bank's Management component rating to "3," (i.e., needs improvement) as early as the second half of 2021.[27] Doing so would have been consistent with the FDIC's forward-looking supervision concept, likely lowering Signature Bank's Composite rating, and supporting consideration of an enforcement action.

Additionally, the report found that the FDIC's communication of examination results to Signature Bank's Board and management was often not timely. Supervisory Letters and annual roll-up examination reports frequently exceeded elapsed-day benchmarks and in some cases were significantly delayed. While staffing shortages impacted timeliness, the FDIC New York Regional Office management's implementation of the continuous examination process contributed to timeliness issues. For example, critical corporate governance examiner findings completed and discussed with bank management in May 2022 were not delivered to Signature Bank's Board of Directors until January 2023, after the issuance of the 2021 roll-up examination in December 2022. Once examiners delivered these findings to the Bank's Board of Directors and discussed the findings with the Board, it was evident that bank management did not previously convey the seriousness of examiner concerns.

From 2017 to 2023, the FDIC was not able to adequately staff an examination team dedicated to Signature Bank, with a number of positions filled on a temporary basis. The dedicated team experienced frequent vacancies and continuous turnover. The vacancies and skillsets of the dedicated examiner team slowed earlier identification and reporting of Signature Bank weaknesses. FDIC has taken actions to address staffing challenges; however, more work is needed.

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[27] Bank examiners review and evaluate an institution's condition using the Uniform Financial Institutions Rating System, also known as CAMELS (Capital, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk). CAMELS ratings are scored on a scale of "1" (best) to "5" (worst). Examiners assign a rating for each CAMELS component and an overall Composite rating.

The report of the FDIC's Chief Risk Officer is a thorough and straightforward review of the causes of Signature Bank's failure, as well as areas where the FDIC's supervision could have been stronger. The challenges identified in the report and the recommendations for further study are an urgent focus of attention and action by the FDIC.

Proposed Special Assessment

The failures of SVB and Signature Bank were due to sudden and unexpected liquidity needs created by large withdrawals of uninsured deposits. By statute, the FDIC is required to recover through special assessments the losses to the DIF incurred as a result of the actions taken pursuant to the determination of systemic risk.[28] The FDIC estimates the cost to the DIF for these failures to be $16.1 billion and $2.4 billion, respectively. Of that estimated total cost of $18.5 billion, the FDIC estimates that approximately $15.8 billion was attributable to the cost of covering uninsured deposits pursuant to the systemic risk determination made on March 12, 2023. However, as with all failed bank receiverships, this estimate will be periodically adjusted as assets are sold, liabilities are satisfied, and receivership expenses are incurred. The exact amount of losses incurred will be determined when the FDIC terminates the receiverships.

On May 11, 2023, the FDIC Board of Directors approved a notice of proposed rulemaking with a 60-day comment period to impose a special assessment to recover the loss to the DIF arising from the protection of uninsured depositors in connection with the systemic risk determination announced on March 12, 2023, following the closures of SVB and Signature Bank, as required by the FDI Act.[29] Under the proposal, the FDIC would apply an annual special assessment rate of approximately 12.5 basis points to an assessment base that would

[28] 12 U.S.C. 1823(c)(4)(G).
[29] See *Notice of Proposed Rulemaking on Special Assessments Pursuant to Systemic Risk Determination*, available at https://www.fdic.gov/news/board-matters/2023/2023-05-11-notice-dis-a-fr.pdf.

equal an insured depository institution's (IDI) estimated uninsured deposits reported as of December 31, 2022. For IDIs that are not part of a holding company, the first $5 billion in estimated uninsured deposits would be excluded from the assessment base. For IDIs that are part of a holding company, the first $5 billion of the combined banking organization's estimated uninsured deposits would be excluded.

Defining the assessment base in this way would effectively exclude most small banks from the special assessment. In implementing the special assessment, the law requires the FDIC to consider the types of entities that benefit from any action taken or assistance provided as well as economic conditions, the effects on the industry, and other factors deemed appropriate and relevant.[30] In general, large banks with large amounts of uninsured deposits benefitted the most from the systemic risk determination. Under the proposal, no banking organizations with total assets under $5 billion would pay the special assessment.

Based on data reported as of December 31, 2022, the FDIC estimates that 113 banking organizations, which include IDIs that are not subsidiaries of a holding company and holding companies with one or more subsidiary IDIs, would be subject to the special assessment. Banking organizations with total assets over $50 billion would pay over 95 percent of the special assessment.

The FDIC is proposing to collect the special assessment at an annual rate of approximately 12.5 basis points, over eight quarterly assessment periods, which it estimates will result in total revenue of $15.8 billion. Because the estimated loss pursuant to the systemic risk determination will be periodically adjusted, the FDIC would retain the ability to cease collection early, extend the special assessment collection period beyond the initial eight-quarter collection period to

[30] 12 U.S.C. 1823(c)(4)(G)(ii)(III).

collect the difference between actual or estimated losses and the amounts collected, and impose a final shortfall special assessment on a one-time basis after the receiverships for SVB and Signature Bank terminate. The FDIC is proposing an effective date of January 1, 2024, with special assessments collected beginning with the first quarterly assessment period of 2024 and the first payment due on June 28, 2024, providing time for institutions to prepare and plan for the special assessment.

As proposed, the FDIC estimates that it would collect through the special assessment the estimated loss from protecting uninsured depositors at SVB and Signature Bank of approximately $15.8 billion. In order to preserve liquidity at IDIs, and in the interest of consistent and predictable assessments, the special assessment would be collected over eight quarters.

Consistent with generally accepted accounting principles, it is assumed that the effects of the special assessment on capital and income would be recognized in one quarter only. Given the estimated loss amount, the FDIC estimates that the proposed special assessment would result in an average estimated one-quarter reduction in income of 17.5 percent for banking organizations subject to the special assessment. The FDIC also estimates that the proposed special assessment would decrease the dollar amount of Tier 1 capital of banking organizations that would be required to pay the special assessment by an estimated 0.61 percent, on average. No banking organizations are expected to become less than well capitalized as a result of the special assessment.

Comments on the proposal are due 60 days from the date of publication in the Federal Register. The FDIC will carefully consider the comments received when developing a final rule.

Review of the Deposit Insurance System

The FDIC was established in 1933 in response to widespread bank runs and bank failures that inflicted severe damage on the U.S. economy.[31] Although many banks have failed since, with the advent of FDIC insurance all insured deposits have been fully protected.

The failures of SVB and Signature Bank, and the approval of the recommendation for a Systemic Risk Exception, raised fundamental questions about the role of deposit insurance in the United States banking system. To address the broader questions about the role of deposit insurance to promote financial stability and prevent bank runs, at my request, the FDIC initiated a comprehensive report to place these recent bank failures in the context of the history, evolution, and purpose of deposit insurance since the FDIC's creation. The report, *Options for Deposit Insurance Reform*, was released on May 1, 2023, and examines the role of deposit insurance, as well as additional policies and tools that may complement changes to deposit insurance coverage.[32]

The bank failures of March 2023 suggest that the banking system has evolved in ways that could increase its exposure to deposit runs. These developments include the increased volume and proportion of uninsured deposits in the banking system, the ease and speed of moving deposits to other deposit accounts or non-deposit alternatives with the widespread adoption of mobile banking, and the amplification of concerns through social media.

At its peak in 2021, the proportion of uninsured deposits in the banking system was 46.6 percent, higher than at any time since 1949. Uninsured deposits are held in a small share of accounts but can be a large proportion of banks' aggregate funding, particularly among the

[31] The current deposit insurance requirements may be found in the FDI Act, 12 U.S.C. 1811, *et seq.*
[32] See *FDIC Releases Comprehensive Overview of Deposit Insurance System, Including Options for Deposit Insurance Reform*, FDIC: PR-35-2023 (May 1, 2023), available at https://www.fdic.gov/news/press-releases/2023/pr23035.html.

largest ten percent and largest one percent of banks by asset size. Large concentrations of uninsured deposits, or other short-term demandable liabilities, increase the potential for bank runs and can threaten financial stability.

The ubiquity of social media and mobile banking may mean that bank runs, when they occur, happen much faster than they have in the past. Technological advances in the financial sector allow for large financial transactions to occur with unprecedented ease. Depositors can easily set in motion the transfer of millions of dollars, open and close accounts, link bank accounts with other financial accounts, and move funds across asset classes. In addition, the role of social media in the SVB depositor run illustrates the dynamics that can arise. Social media posts advised depositors to withdraw funds from SVB, and uninsured depositors did so all at once. The concentration of these large deposits in technology industry firms and individuals who appear to have been part of closely overlapping virtual communities may have contributed to the synchronized nature of the deposit outflows.

The effectiveness of deposit insurance depends upon how it is used with other policy tools. Regulation and supervision play important roles in constraining moral hazard and supporting financial stability. Tools such as capital requirements and supervision of bank growth can reduce moral hazard that arises from deposit insurance, and regulation and supervision of liquidity can help reduce run risk.

This report evaluates three options to reform the deposit insurance system: (1) Limited Coverage, which maintains the current structure of deposit insurance in which there is a finite deposit insurance limit (possibly higher than the current $250,000 limit) by ownership rights and capacities; (2) Unlimited Coverage, which extends unlimited deposit insurance to all depositors; and (3) Targeted Coverage, which allows for different levels of deposit insurance coverage

across different types of accounts and focuses on higher coverage for business payment accounts. Although each option has strengths and weaknesses, which are discussed in greater detail in the report, Targeted Coverage for business payment accounts captures many of the financial stability benefits of expanded coverage while mitigating many of the undesirable consequences.

Because losses on uninsured deposits associated with business payments are most likely to create spillovers, providing higher coverage on these deposits increases financial stability without expanding the safety net more broadly. Relative to savings and investment accounts, business payment accounts are less likely to seek yield and are more difficult to diversify across banks in the current system to obtain full deposit insurance. However, there are significant unresolved practical challenges to Targeted Coverage, including defining accounts for additional coverage and preventing depositors and banks from circumventing differences in coverage.

It should also be noted that all of the options for expanding deposit insurance coverage examined in the study would require Congressional action. The FDIC remains committed to engaging with the public, as well as with stakeholders in the industry and with policymakers in the Congress as policies to strengthen the deposit insurance system and meet emerging challenges are considered.

Update on the FDIC's Regulatory Agenda

Strengthening and Modernizing the Community Reinvestment Act

On June 3, 2022, the three federal banking agencies – the Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the FDIC adopted a NPR in an effort to strengthen and enhance the Community Reinvestment Act's (CRA) effectiveness in achieving its core mission by: expanding access to credit, investment, and basic banking services in low- and moderate-income (LMI) communities; adapting to changes in the banking industry, including

mobile and internet banking by modernizing assessment areas while maintaining a focus on branch-based areas; providing greater clarity, consistency, and transparency in the application of the regulations through the use of standardized metrics as part of CRA evaluation and clarifying eligible CRA activities focused on LMI communities and under-served rural communities; tailoring CRA rules and data collection to bank size and business model; and maintaining a unified approach among the regulators.[33]

The last major revision of the rule implementing CRA occurred in 1995, over 25 years ago. A great deal has changed in the banking industry during that time. 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.[34] 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.

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.[35] 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.

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[33] 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.
[34] 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.
[35] See Basel III, International Framework for Banks, available at https://www.bis.org/bcbs/basel3.htm.

In September 2022, 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.[36] 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. Community banks, which are subject to different capital requirements, would not be impacted by the proposal, given their limited overall size and trading activities.

Resolution-Related Long-Term Debt Requirement for Large Banking Organizations

In October 2022, the FDIC Board approved the publication of an Advance Notice of Proposed Rulemaking (ANPR) concerning potential new resolution-related resource requirements, such as a long-term debt requirement, for large banking organizations to improve the prospects for the orderly resolution of large banks in the United States. The ANPR was proposed jointly by the FDIC and the Board of Governors of the Federal Reserve System.[37] In order to improve the prospects for the orderly resolution of large banks in a way that minimizes the destruction of value, addresses the impact on depositors and local communities, maintains U.S. financial stability, while minimizing the cost to the DIF, the agencies believed it was appropriate to consider whether additional measures are warranted to increase the resources available for an orderly resolution of a large bank. This includes whether a layer of loss-

[36] See *Agencies Reaffirm Commitment to Basel III Standards,* FDIC PR-65-2022, (September 9, 2022), available at https://www.fdic.gov/news/press-releases/2022/pr22065.html.
[37] Resolution-Related Resource Requirements for Large Banking Organizations, 87 Fed. Reg. 64170 (October 24, 2022).

absorbing debt held at the bank would be effective in supporting options to resolve large insured depository institutions across a range of scenarios.

The comment period for the ANPR closed on January 23, 2023, with 65 comments received. This ANPR was the first step in developing an approach to address the risks associated with the resolution of large banks, including the risks to the DIF, to the customers and counterparties of the banks, to local communities, and to the safety and soundness and stability of the banking system. The recent bank failures demonstrate the implications that banks with assets of $100 billion or more can have for financial stability. Given the financial stability risks caused by the recent failures, the methods for planning and carrying out a resolution of banks with assets of $100 billion or more merit special attention, including consideration of a long-term debt requirement to facilitate orderly resolutions. A long-term debt buffer would have also improved the likelihood that an all-deposits bridge bank resolution would have met the least-cost resolution requirement, and protected all uninsured depositors without use of a systemic risk exception. To the extent that losses to the depositor class are absorbed by a buffer of long-term debt, it is more likely that the preservation of that franchise value will reduce the cost to the DIF and support the determination that an all-deposits bridge is the least-costly approach to resolution. For that reason, the agencies are considering issuing in the near future a proposed rulemaking to implement resolution-related long-term debt requirements for banking organizations with at least $100 billion in assets.

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.[38] FDIC approval is also required for a bank merger with a non-insured entity.[39] 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.[40] 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.[41]

In March 2022, 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).[42] 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.

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[38] 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.

[39] 12 U.S.C. § 1828(c)(1) and (2).

[40] 12 U.S.C. § 1828(c)(5).

[41] 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.

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

Although there has been a significant amount of consolidation in the banking sector over the last thirty 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. Particularly in light of recent events, a review of the regulatory framework implementing the BMA is both timely and appropriate.

The comment period closed on May 31, 2022, with 31 comments received.[43] 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 banking agencies and the Department of Justice on an interagency review of the bank merger application process.

Conclusion

The banking industry has proven to be quite resilient during this period of stress. Early reports from first quarter 2023 indicate that first quarter aggregate bank net income was roughly unchanged compared to the fourth quarter, excluding the effects on acquirers' incomes of their acquisitions of failing banks. In addition, asset quality metrics remain favorable, and the industry remains well capitalized. Recent declines in medium- and long-term rates have reduced somewhat the volume of unrealized losses on securities.

Nevertheless, there are significant downside risks to the outlook. These include the potential for weakening credit quality and profitability that could result in further tightening of loan underwriting, slower loan growth, and higher provision expenses. CRE loan portfolios,

[43] 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.

particularly loans backed by office properties, face challenges should demand for office space remain weak and property values continue to soften.

Given these risks, the FDIC will be focused on monitoring the condition of the banking industry, including the impacts of the recent bank failures on liquidity; giving close consideration to the recommendations and options resulting from the studies on the FDIC's supervision of Signature Bank and the deposit insurance system, respectively; and pursuing several important rulemakings.

Finally, the failures of SVB and Signature Bank also demonstrate the implications that banks with assets of $100 billion or more can have for financial stability. The prudential regulation and supervision of these institutions merits additional attention, particularly with respect to capital, liquidity, and interest rate risk. This would include the capital treatment associated with unrealized losses in banks' securities portfolios. Given the financial stability risks caused by the failed banks, the methods for planning and carrying out a resolution of banks with assets of $100 billion or more also merit special attention, including consideration of a long-term debt requirement to facilitate orderly resolutions.

The FDIC remains committed to engaging with the public, industry stakeholders, and members of Congress on the policies and priorities outlined in this testimony.

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Statement by
The Honorable Todd M. Harper
Chairman, National Credit Union Administration
Before the U.S. House of Representatives
Committee on Financial Services

Oversight of Prudential Regulators

May 16, 2023

Chairman McHenry, Ranking Member Waters, and members of the committee, thank you for inviting me to discuss the state of the credit union system and to provide an update on the operations, programs, and initiatives of the National Credit Union Administration (NCUA).

The NCUA protects the safety and soundness of the credit union system by identifying, monitoring, and managing risks to the National Credit Union Share Insurance Fund (Share Insurance Fund). The NCUA also protects the credit union system and its members by ensuring credit unions operate safely and soundly and in compliance with applicable laws and regulations, including those related to consumer financial protection. Additionally, the agency continues to prioritize equitable access to credit union members of safe, fair, and affordable financial products and services to ensure that the credit union system fulfills its statutory mission of meeting the credit and savings needs of members, especially people of modest means.[1]

In my testimony today, I will discuss the state of the credit union industry, some of the NCUA's recent efforts to strengthen the system, and a few critical legislative requests.

State of the Credit Union System

First, the overall performance of federally insured credit unions (credit unions) and the Share Insurance Fund has remained stable despite ongoing inflationary pressures and a higher interest rate environment.[2] Over the past year, total loans, assets, insured shares, and deposits all increased. Insured share growth, however, has slowed as some members have drawn down built-up savings and accumulated more debt.[3]

Nevertheless, the credit union system, as a whole, is currently well positioned to handle any economic dislocation resulting from a moderate recession. The NCUA is also prepared to respond to economic uncertainty and will continue to work with individual credit unions experiencing liquidity and interest rate risks to assist them in responding to declines in economic activity or financial market instability.

Credit Union System Performance

As of December 31, 2022, there were 4,760 natural-person credit unions with 135 million members.[4] The system's total assets were $2.2 trillion. The system's net worth ratio rose to 10.75 percent, representing a recovery of 73 basis points from a pandemic low of 10.02 percent. Notably, credit unions recorded a 20 percent year-over-year increase in loans.

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[1] An Act to establish a Federal Credit Union System, to establish a further market of securities of the United States and 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. *Preamble.* 12 U.S.C. 1751.

[2] The term credit union in this testimony refers to federally insured credit unions.

[3] *See* https://www.ncua.gov/newsroom/speech/2023/ncua-chairman-todd-m-harper-statement-federal-credit-union-loan-interest-rate-ceiling; Shannon Pettypiece, "Shrinking savings and rising debt leave consumers on shaky financial footing," NBC News, March 18, 2023. Available at: https://www.nbcnews.com/politics/economics/shrinking-savings-rising-debt-leave-consumers-shaky-financial-footing-rcna75389.

[4] *See* https://ncua.gov/files/publications/analysis/quarterly-data-summary-2022-Q4.pdf.

During the last decade, the credit union system has grown in size and complexity. As of December 31, 2022, the number of billion-dollar-plus credit unions more than doubled to 421, compared to 193 in 2012. Together, these billion-dollar-plus credit unions held $1.6 trillion in assets, representing three out of every four dollars within the credit union system. This cohort of credit unions also reported the highest growth in loans, membership, and net worth over the year ending December 31, 2022.

While the credit union industry has experienced overall growth, credit unions with less than $500 million in assets have declined in number over the last year and decade. The NCUA recognizes smaller credit unions must operate in an increasingly complex and competitive financial services landscape with limited resources. Yet, these credit unions serve more than 25 million members and form the foundation of the credit union system.

To support smaller credit unions, the NCUA has developed streamlined examination procedures for all credit unions with less than $50 million in assets. In 2022, the NCUA also launched a support initiative for credit unions with assets below $100 million to provide additional resources, training, and guidance for credit union management.[5] Further, the agency supports small credit unions through webinars, Community Development Revolving Loan Fund (CDRLF) grants, and promoting partnerships with organizations and industry mentors.

External Factors Impacting the System

The NCUA expects several external factors to influence credit union performance in the months ahead. For example, forecasters expect tighter credit conditions to lead to reduced economic growth. Job growth is also likely to slow, which would place upward pressure on the unemployment rate. That, in turn, could lead to increases in delinquencies and charge-offs at credit unions.

Interest rate increases have also led to rising funding costs for depository institutions. The measure and speed of interest rate increases necessitate greater discipline for market sensitivity and liquidity risk management for all financial institutions, including credit unions.

Thus, the management of interest rate risk will be a crucial factor in credit union performance for the remainder of 2023. As rates increase, the associated liquidity risk also increases. The potential for sudden changes in inflation, the interest rate environment, or the economy means credit unions—and the NCUA—must be nimble and vigilant.

While still adequate, credit union liquidity has decreased from its elevated position throughout the COVID-19 pandemic. Cash positions have declined and are below pre-pandemic levels. Further, unrealized losses in securities limit their utility as a source of liquidity. This rise in liquidity risk has affected credit unions of all sizes, including several credit unions with more than $1 billion in assets that pose greater risks for the Share Insurance Fund.

The current inflationary environment creates financial pressure on credit union members by increasing costs of living and reducing members' ability to repay debts. Higher interest rates also increase the costs for borrowers with adjustable-rate loans—for example, variable-rate credit

[5] The NCUA has budgeted 4,500 hours of staff support time under this initiative in 2023.

cards and adjustable-rate mortgages—and impede members' ability to refinance existing debt. Additionally, higher interest rates put downward pressure on collateral values, such as residential real estate and vehicles, which could increase credit union losses.

As part of its pandemic-response efforts, the NCUA implemented enhanced monitoring and updated procedures related to various risks, including liquidity and credit. Staff also received training on problem resolution, and the NCUA increased specialist staffing after evaluating resource needs. Starting in early 2022, the NCUA proactively refreshed training and supervisory tools as interest rates rose. Additionally, the agency has offered additional staff training related to rising interest rates, the associated liquidity risk in credit unions, and overall balance sheet management.

Meanwhile, the Share Insurance Fund adjusted its liquidity target, increasing the target to $4 billion, which represents 20 percent of the total portfolio. The NCUA is also a party to the interagency effort to finalize the "Policy Statement on Prudent Commercial Real Estate Loan Workouts and Accommodations." The final policy statement will provide resources for credit unions to consider when engaging with commercial real estate loan borrowers experiencing financial difficulties.

Together, these and other actions by the NCUA have better positioned the agency and the credit union industry to respond to various potential economic conditions in the months ahead.

Performance of the National Credit Union Share Insurance Fund

In uncertain economic times, it is essential to maintain the strength of the Share Insurance Fund. Backed by the full faith and credit of the United States, this fund insures individual accounts up to at least $250,000.[6] As of December 31, 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. In contrast, total uninsured shares stood at $166.2 billion for the year ending December 31, 2022. Thus, the fund insures and protects 91 percent of total share deposits within the credit union system.

The Share Insurance Fund also continues to perform well, with no premiums expected at this time. At the end of 2022, the Share Insurance Fund reported a net income of $118.7 million, a net position of $20.4 billion, and an equity ratio of 1.30 percent.[7] For the period ending June 30, 2023, the NCUA projects the equity ratio for the Share Insurance Fund to decline to 1.25 percent, below the 1.33 percent normal operating level set by the NCUA Board. The decline in the projected equity ratio is typical in the first half of the year and results primarily from projected share growth. It does not reflect a projected increase in credit union failures.

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[6] The standard share insurance amount is $250,000 per share owner, per insured credit union, for each account ownership category. The $250,000 standard share insurance account became permanent through the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. *See* https://ncua.gov/files/publications/guides-manuals/NCUAHowYourAcctInsured.pdf.

[7] The equity ratio is the overall capitalization of the insurance fund to protect against unexpected losses from the failure of credit unions. When the equity ratio falls, or is projected within six months to fall, below 1.20 percent, the NCUA Board must assess a premium or develop a restoration plan. When the equity ratio exceeds the normal operating level and available assets ratio at year-end, the Share Insurance Fund pays a distribution.

State of the Central Liquidity Facility

The increase in interest rate risk and liquidity risk in the current economic environment underscores the value of the NCUA's Central Liquidity Facility (CLF).[8] The CLF's ability to respond rapidly to economic events can help contain or avert liquidity crises before they escalate. As noted earlier, liquidity risk for some credit unions, including several with more than $1 billion in assets, has recently increased. When liquidity events occur, the CLF can serve as an important shock absorber.

Under the NCUA's regulations, credit unions with more than $250 million in assets are required as part of their contingency funding plan to have access to a federal emergency liquidity source—the CLF, the Federal Reserve's Discount Window, or both. Credit unions with less than $250 million in assets, while not required to have a membership with a contingent federal liquidity source, are required to identify external sources as part of their contingency funding plan.

In December 2022, the temporary statutory enhancements that assisted the agent membership of corporate credit unions expired. As a result, 3,322 credit unions with less than $250 million in assets lost access to the CLF, and the facility's capacity contracted by almost $10 billion.[9]

To address this expiration and growing liquidity risks within the credit union system, the NCUA Board has unanimously asked Congress for permanent statutory authority to allow corporate credit unions—or credit unions serving other credit unions—and other agent members of the CLF to purchase capital stock for a subset of the credit unions they serve. These statutory adjustments would make the facility a more affordable option for corporate credit unions to subscribe to on behalf of their smaller credit union members so that this liquidity source can assist more institutions. Notably, the Congressional Budget Office has scored the CLF reforms at no cost to the taxpayer.[10]

NCUA's Efforts to Strengthen the Credit Union System

In recent months, the NCUA has undertaken several actions to enhance cybersecurity; improve consumer financial protections; support low-income designated credit unions and minority depository institutions (MDIs); advance diversity, equity, and inclusion; and consider new rules to strengthen the system.

Enhancing Cybersecurity

The potential for cyberattacks in the financial services industry and the credit union system is high and will likely stay that way for the foreseeable future. The NCUA, therefore, remains vigilant in its cybersecurity posture and continues to focus on advancing consistency,

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[8] Established by statute, the CLF is a mixed-ownership government corporation created to improve the general financial stability of credit unions by serving as a liquidity lender to credit unions experiencing unusual or unexpected liquidity shortfalls. Member credit unions own the CLF, which exists within the NCUA. The CLF's president manages the facility under the oversight of the NCUA Board.

[9] Coronavirus Aid, Relief, and Economic Security Act, Public Law 116-136, 134 Stat 281 (March 27, 2020).

[10] The Congressional Budget Office has traditionally scored enhancements to the CLF as having no cost; see text on the bottom of page four of the Congressional Budget Office score of S. 414, Credit Card Accountability Responsibility and Disclosure Act of 2009.

transparency, and accountability within the agency's cybersecurity examination program. Specifically, the NCUA is:

- providing credit unions with information and resources to improve their preparedness and resiliency;
- safeguarding its systems and information; and
- increasing the credit union system's capacity to reduce the potential for systemic risks.

The NCUA has also notified credit unions about the increased likelihood of cyberattacks resulting from geopolitical and other cyber events. As institutions that qualify as U.S. critical infrastructure, credit unions of all sizes can be subject to cyberattacks and should adopt a heightened state of awareness. The NCUA urges credit unions to implement appropriate controls in the technology they use to deliver member services.

Earlier this year, the NCUA deployed updated, scalable, and risk-focused Information Security Examination (ISE) procedures. These procedures focus on compliance with parts 748 and 749 of NCUA regulations and align closely with the voluntary Automated Cybersecurity Evaluation Toolbox (ACET) maturity assessment. The ISE examination initiative offers flexibility for credit unions while providing examiners with standardized review steps to facilitate advanced data collection and analysis. Together with the ACET maturity assessment, the new ISE procedures will assist the agency in protecting the credit union system from cyberattacks.

The agency also recognizes that it must collaborate with credit unions in identifying attacks before they become systemic and threaten the broader financial services sector. Accordingly, the NCUA Board in February approved a new cyber incident reporting rule, which goes into effect on September 1, 2023.[11] The final rule requires a federally insured credit union to report cyber incidents that rise to the level of a reportable incident as soon as possible but no later than 72 hours after it reasonably believes a reportable cyber incident has occurred. This final rule aligns with the NCUA's broader focus on cybersecurity safeguards requiring faster notifications when incidents occur.

Improving Consumer Financial Protection

Because safety and soundness and consumer financial protection are mutually reinforcing aspects of the NCUA's mission, the NCUA actively examines for compliance with consumer financial protection laws and regulations for credit unions within its supervisory authority.[12]

For 2023, the agency's consumer financial protection supervisory priorities include overdraft protection, fair lending, residential real estate appraisal bias, and Truth in Lending Act and Fair Credit Reporting Act compliance. The NCUA has also prioritized the examination of credit union compliance with the Flood Disaster Protection Act, including disclosure requirements, as we evolve our understanding of climate-related financial risk.[13]

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[11] 12 CFR Part 748.
[12] *See* the *NCUA Strategic Plan 2022–2026*.
[13] Letter to Credit Unions, 23-CU-01, "NCUA's 2023 Supervisory Priorities" available at https://ncua.gov/regulation-supervision/letters-credit-unions-other-guidance/ncuas-2023-supervisory-priorities.

Notably, the NCUA has increased its focus on overdraft practices at credit unions to assess whether the amount and manner of overdraft and nonsufficient funds fees are potentially unfair and detrimental to credit union members, particularly those of modest means. Overdraft and nonsufficient funds fees should be reasonable and proportional, credit union members should have the ability to anticipate and avoid fees, and credit unions should not overly rely on this fee income for revenue.

As such, NCUA examiners are focusing on unanticipated overdraft fees such as authorized positive/settle negative fees (or fees for debit card transactions where the consumer had a sufficient available balance when the transaction was initiated and authorized but not when the transaction cleared), representment fees charged multiple times in close succession for insufficient funds for a single purchase or transaction, and return deposit fees for third-party checks that are returned unpaid or "bounce."

The NCUA's supervision regarding this service aims to create a more equitable system that supports financial stability for credit union members, discourages over reliance on fee income from one source, and improves transparency.

Supporting Under-Resourced Communities

Low-income designated credit unions[14] and MDIs support the NCUA's mission of providing people of modest means and under-resourced communities with access to safe, fair, and affordable financial services and products. Low-income credit unions and MDIs also represent a sizable portion of the credit union system.

As of December 31, 2022, 2,612 federally insured credit unions with low-income designations served nearly 71 million members and held more than $1 trillion in assets. Additionally, 503 federally insured credit unions had the MDI designation, with 411 MDI credit unions also holding the low-income designation. Together, MDI credit unions serve more than 5 million members and hold nearly $65 billion in assets.

Overall, MDI credit unions generally saw improved financial performance between the end of 2021 and 2022. Over that year, total assets grew by $5.8 billion, or 9.8 percent. MDIs added more than 600,000 members, an increase of 14.1 percent, and loans grew approximately $7.9 billion, or 23.2 percent. MDI credit unions' growth also outpaced federally insured credit unions in these core metrics.

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[14] The low-income designation is critical to the NCUA's efforts to support credit unions. To qualify as a low-income-designated credit union, most 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. Additionally, there are several benefits associated with the designation. Under 12 CFR 701.34, low-income credit unions have:

- an exception from the statutory cap on member business lending, which expands access to capital for member small businesses and helps credit unions to diversify portfolios;
- eligibility for grants and low-interest loans from the CDRLF;
- the ability to accept non-member deposits from any source; and
- the authority to obtain supplemental capital.

Consistent with the law, the NCUA is focused on supporting and preserving MDI credit unions.[15] In 2023, the NCUA began using new procedures to examine MDIs. The new procedures contain customized guidance and insight into MDI credit unions' unique strategies and member needs. Because MDI credit unions have distinct business models, the guidance provides instruction on how examiners can utilize MDI peer metrics, as opposed to traditional peer metrics, when assessing performance. For 2023, the NCUA also allocated more than 5,500 staff hours for direct one-on-one support of MDIs.

The NCUA deeply appreciates that Congress more than doubled the funding for CDRLF grants in 2023. For many years, the number of grant requests significantly exceeded the amount of appropriated funds. With these additional dollars, the NCUA plans to make more grants and bigger grants to low-income credit unions and MDIs. Congress, at the NCUA's request, also now allows MDIs to be eligible for CDRLF grants and loans, regardless of the MDI's low-income credit union status. This, too, is a welcome change.

The 2023 CDRLF grant round opened on May 1 and will close on June 23. In all, NCUA will distribute $3.5 million in CDRLF grants in five categories—underserved outreach, MDI capacity building, consumer financial protection, digital services and cybersecurity, and training—as well as two pilot projects to foster innovation by credit unions and partnerships between small credit unions.

Advancing Diversity, Equity, and Inclusion

The NCUA appreciates that it must lead by example in advancing diversity, equity, and inclusion within the agency and across the credit union system.

Accordingly, the NCUA actively recruits, hires, and retains a diverse workforce. In 2022, two out of five new NCUA hires were people of color. The agency also exceeded the federal employment goals by 5.1 percentage points for employees with disabilities and 2.3 percentage points for employees with targeted disabilities.

There are, however, areas where the NCUA can improve in achieving its hiring goals. Hiring and retaining Hispanic employees at the agency is one of those areas.[16] Accordingly, the NCUA is conducting a barrier analysis to determine why this challenge exists and how best to overcome it. The agency is committed to better results in the future.

Additional NCUA initiatives to support diversity, equity, and inclusion include training, employee resource groups, and special emphasis programs. Last year, nearly two-thirds of the participants in NCUA's leadership development programs were female, reflecting the commitment to ensuring equitable opportunities in our leadership pipeline.

Diverse suppliers and vendors also are important to the economic success of small businesses and diverse communities. The NCUA supports minority- and women-owned businesses through our supplier diversity program. This program identifies minority- and women-owned businesses and invites them to compete for all NCUA contracts, including our largest projects. In all, the

[15] Section 308 of the Financial Institutions Reform, Recovery and Enforcement Act of 1989.
[16] *See* https://ncua.gov/files/publications/2022-omwi-congressional-report.pdf.

NCUA awarded 45 percent of its contract dollars in 2022 to minority- and women-owned businesses, and 38.5 percent of contract payments went to these vendors.

Additionally, the NCUA's voluntary Credit Union Diversity Self-Assessment (CUDSA) helps credit unions assess their progress in implementing diversity standards.[17,18] The NCUA encourages credit unions to submit a CUDSA each year and publishes an annual report of the self-assessment results on NCUA.gov. In 2022, 481, or 10 percent of all federally insured credit unions, submitted a self-assessment. Of those, 302 were federally chartered credit unions, 178 were federally insured and state-chartered, and one was a non-federally insured, state-chartered credit union. The number of CUDSA responses is twice as much as the 240 self-assessments submitted in 2021.

Rulemaking

In addition to the final rule regarding cyber incident notification referenced earlier, the NCUA Board recently proposed two other important rules.

In December 2022, the NCUA Board published a proposed rule to clarify the NCUA's current regulations and provide additional flexibility for credit unions to use advanced technologies and take advantage of opportunities offered by the fintech sector.[19] The proposal would also make conforming amendments to the NCUA's rule regarding loans and lines of credit to members by adding new provisions about indirect lending arrangements and indirect leasing arrangements.

In October 2022, the NCUA Board issued another proposed rule in response to the Credit Union Governance Modernization Act of 2022.[20,21] Pursuant to that act, the NCUA has 18 months following the date of enactment 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 credit union's board of directors.

The NCUA is currently reviewing the comments received on both rulemakings and expects to issue final rules during the third quarter.

Legislative Requests

Last year, the House passed both H.R. 3958, the Central Liquidity Facility Enhancement Act, to renew the CLF expiring authority for an additional year, and H.R. 7022, the Strengthening Cybersecurity for the Financial Sector Act, that restored the NCUA's third-party vendor examination authority, as part of the 2023 National Defense Authorization Act. As neither bill became law, the NCUA encourages the 118th Congress to revisit both proposals to strengthen the system.

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[17] *See* https://ncua.gov/about/diversity-inclusion/credit-union-diversity/credit-union-diversity-self-assessment.
[18] Department of Treasury, "Final Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies," *Federal Register* Vol. 80, No.111 (June 10, 2015). *See* https://www.govinfo.gov/content/pkg/FR-2015-06-10/pdf/2015-14126.pdf.
[19] 12 CFR Parts 701 and 714; *See* https://www.regulations.gov/document/NCUA-2022-0185-0001.
[20] *See* Credit Union Governance Modernization Act of 2022, Pub. L. 117-103, 12 U.S.C. §1764 (2022), available at https://amendments-rules.house.gov/amendments/DELAURO_01_xml220309170415113.pdf.
[21] 12 CFR Part 701, Appendix A. *See* https://ncua.gov/files/agenda-items/member-expulsion-proposed-rule-20220922.pdf.

The recent failures of Silicon Valley, Signature, and First Republic banks are a reminder of the dangers of concentration risk and the need for effective risk-management policies and practices to manage capital, interest rate risk, and liquidity risk. These fundamentals have remained true throughout all economic and regulatory cycles and have recently been areas of supervisory focus for the NCUA. Credit unions that fail to manage these core issues can and will continue to fail.

Accordingly, to better manage such liquidations in the future, the NCUA requests amendments to the Federal Credit Union Act to provide more flexibility to the NCUA Board to manage the Share Insurance Fund, bringing the fund's operations more in line with those of the Deposit Insurance Fund administered by the Federal Deposit Insurance Corporation (FDIC). Likewise, as Congress considers amending federal deposit insurance requirements, the NCUA supports maintaining parity between the Share Insurance Fund and the Deposit Insurance Fund.

Central Liquidity Facility Reforms

With liquidity risks rising within the financial system and at individual credit unions, now is not the time to cut a liquidity lifeline. As such, and as outlined earlier, the NCUA Board fully supports restoring the ability of corporate credit unions to serve as CLF agents on behalf of a subset of their members.

On February 28, 2023, Senators Padilla and Cramer introduced a bill to allow corporate credit unions to purchase capital stock on behalf of a subset of their members. This bill would allow them to contribute capital to provide coverage for their smaller members with less than $250 million in assets.[22]

The NCUA Board respectfully requests consideration of similar legislation in the House. Liquidity risks within the credit union system are rising, and timely consideration of this bill would better protect the credit union system from a future liquidity event.

Restoration of Third-Party Vendor Authority

Congress should also restore the NCUA's statutory examination authority over third-party vendors and enforcement and examination authority for credit union service organizations (CUSOs) that expired more than 20 years ago. The world's interconnectedness has changed considerably in the last two decades. This statutory amendment would give the NCUA parity with the other federal banking agencies that supervise and regulate federally insured depository institutions.

Currently, the NCUA may only review credit union third-party vendors with their permission, and vendors often decline these requests. Vendors and CUSOs may also reject the NCUA's recommendations to implement appropriate corrective actions that mitigate identified risks. Thus, the current vendor and CUSO review process falls short of protecting the credit union system.

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[22] *See* U.S. Senate Bill, S. 544, available at https://www.congress.gov/118/bills/s544/BILLS-118s544is.pdf.

Accordingly, the NCUA requests visibility into these entities. Such visibility will address the credit union system's growing reliance on digital services, increased credit union outsourcing of core business functions, concentration risks, and evolving cyber threats that pose a national security risk.

Vendor examination authority would allow the NCUA to discover and remediate issues that could cause systemic risk if left untreated. Credit unions—a substantive part of our nation's critical economic infrastructure—rely on third parties for core processing services such as mortgage and auto lending, online services, information technology systems development and maintenance, and other member services subject to little or no oversight.

Moreover, the top five technology service providers serve more than half of all credit unions, representing more than 90 percent of the credit union system's assets. A failure of one of these third parties could cause hundreds of credit unions and potentially tens of millions of their members to lose access to their funds simultaneously, resulting in a loss of confidence for the credit union industry and the entire financial sector.

For these reasons and others, the Government Accountability Office and the Financial Stability Oversight Council have repeatedly recommended that Congress approve legislation to restore the NCUA's vendor authority to close this growing regulatory blind spot.[23] The NCUA's Office of Inspector General has done the same. And, 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."[24]

If the NCUA's third-party vendor authority is reauthorized, the agency will adopt a program that prioritizes examinations based on the risks to the Share Insurance Fund, cybersecurity, consumer financial protection, and Bank Secrecy Act/Anti-Money Laundering compliance.

Potential Changes to Share Insurance Coverage Levels and the Share Insurance Fund
Lastly, in the aftermath of recent bank failures, some have called on Congress to adjust the existing $250,000 cap on the share and deposit insurance coverage provided by the NCUA and FDIC, respectively. Others have suggested increasing the coverage limit for non-interest-bearing transaction accounts used by small businesses for payroll and other purposes. And, some others have called for unlimited coverage.

The NCUA defers to Congress on determining what statutory changes, if any, should be made to share and deposit insurance coverage levels and account types. But, if Congress does decide to act in this area, the NCUA has two requests. The first is to maintain parity between the share insurance provided by the NCUA and the deposit insurance provided by the FDIC. Share and deposit insurance parity ensures that consumers receive the same level of protection against losses regardless of their financial institution's charter type. And second, if coverage levels are adjusted in any way, there will be costs associated with those adjustments, such as the need to increase reserves. Accordingly, the NCUA requests additional flexibility for administering the Share Insurance Fund.

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[23] *See* NCUA. Third-Party Vendor Authority. Appendix A. (March 2022).
[24] *See* https://www.ncua.gov/files/agenda-items/AG20211021Item2b.pdf.

Specifically, the NCUA requests amending the Federal Credit Union Act to remove the 1.50-percent ceiling from the current statutory definition of "normal operating level," which limits the ability of the Board to establish a higher normal operating level for the Share Insurance Fund. Congress should also remove the limitations on assessing Share Insurance Fund premiums when the equity ratio of the Share Insurance Fund is greater than 1.30 percent and if the premium charged exceeds the amount necessary to restore the equity ratio to 1.30 percent.[25]

Together, these amendments would bring the NCUA's statutory authority over the Share Insurance Fund more in line with the FDIC's authority as it relates to administering the Deposit Insurance Fund. These amendments would also better enable the NCUA Board to proactively manage the Share Insurance Fund by building reserves during economic upturns so that sufficient money is available during economic downturns. A more counter-cyclical approach would better ensure that credit unions will not need to impair their one-percent contributed capital deposit or pay premiums during times of economic stress, when they can least afford it.

Conclusion

In sum, the credit union system currently remains well-capitalized, stable, and well-positioned to handle a relatively broad range of economic possibilities. Consumers can also remain confident that their insured share deposits at federally insured credit unions are safe, just as they have been for more than 50 years. And, to protect the system and its members going forward, the NCUA will continue to monitor credit union performance through the examination process, offsite monitoring, and tailored supervision at credit unions experiencing problems.

Thank you again for the invitation to testify. I look forward to discussing these issues with the committee and stand ready to work with you in safeguarding and strengthening the credit union system.

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[25] As part of the Federal Deposit Insurance Reform Act of 2006, Congress ended the prohibition on the FDIC's charging of risk-based premiums to well-capitalized institutions (which constituted most of the industry) when the reserve ratio was at or above its target. *See* section 2107(a) of Pub. L. No. 109-171 (Feb. 8, 2006). *Compare with* § 1782(c)(2)(B) (providing in relevant part: "The [NCUA] Board may assess a premium charge only if—(i) the [Share Insurance] Fund's equity ratio is less than 1.30 percent; and (ii) the premium charge does not exceed the amount necessary to restore the equity ratio to 1.30 percent.").

For Release Upon Delivery
10:00 a.m. May 16, 2023

STATEMENT OF

MICHAEL J. HSU

ACTING COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANICAL SERVICES

UNITED STATES HOUSE OF REPRESENTATIVES

May16, 2023

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

Introduction

I am pleased to testify before the Committee on Financial Services to provide information about the Office of the Comptroller of the Currency's (OCC) actions and responses to recent market stress, and to update Members of the Committee on efforts underway as we work 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"). These institutions 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 have less than $1 billion in assets, while 56 have greater than $10 billion in assets. Together, OCC-supervised financial institutions hold more than $15 trillion in assets—almost 65 percent of all the assets held in commercial U.S. banks.

The federal banking regulators have worked closely together since March to maintain financial stability and confidence in the banking system in response to the recent market stress. Adequate levels of capital going into the recent turmoil have helped to limit the risk of contagion. Despite the market stress, the federal banking system has remained resilient and national banks and federal savings associations have remained well positioned to serve their customers.

The OCC is closely monitoring the conditions of the institutions we supervise and working with them to ensure that their liquidity and capital positions remain sound and that they are "on the balls of their feet" with regard to risk management. The vast majority of OCC-supervised banks have not experienced stress with regard to their depositors or business customers. After the failures of Silicon Valley Bank and Signature Bank, we carefully reviewed the condition of the federal banking system, including banks with significant levels of uninsured deposits to ensure that their cash holdings and borrowing capacity can easily meet potential depositor withdrawals. In addition, many have taken steps to reduce risk in light of market conditions.

Over the past two years, I have consistently emphasized to bankers the importance of guarding against complacency and having strong risk management policies and practices in place. Most OCC regulated banks have heeded this message and been able to successfully navigate the rise in interest rates and changing economic outlook. OCC examiners will continue to actively

monitor market conditions and engage with banks to help ensure they are prepared to meet future challenges.

My written statement begins with observations about recent events, then provides an overview of our work to advance four critical agency priorities that I initiated after becoming Acting Comptroller two years ago.

Observations on the Recent Bank Failures

The recent bank failures have prompted several reviews of the strengths and weaknesses of bank regulatory frameworks and supervisory programs.[1] While none of the failed banks were regulated by the OCC, we are using those reviews to do a "look across" and evaluate our own supervisory processes to identify any areas that may need adjustment.

Based on my perspective as Acting Comptroller and twenty years of experience as a financial regulator, I would like to offer some preliminary observations on steps that can be taken to restore full confidence in the banking system.

Supervisors need support to act in a timely and effective manner. The reviews by the state and primary federal regulators of Silicon Valley Bank (SVB) and Signature Bank shared a consistent theme. Awareness and identification of weaknesses were not the problem; rather, timely and forceful supervisory action were lacking.

Supervisors at the OCC and the other banking agencies play a critical role in keeping the banking system safe and sound by exercising discretion. The degree to which supervisors feel empowered to exercise that discretion impacts their will to act in a timely and forceful manner. Clear support to empower supervisors to exercise discretion and act when needed will help keep the banking system safe and sound.

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[1] U.S. Government Accountability Office, "Bank Regulation: Preliminary Review of Agency Actions Related to March 2023 Bank Failures," (April 28, 2023); Board of Governors of the Federal Reserve System, "Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank," (April 28, 2023); California Department of Financial Protection and Innovation, "Review of DFPI's Oversight and Regulation of Silicon Valley Bank," (May 8, 2023); Federal Deposit Insurance Corporation, "FDIC's Supervision of Signature Bank," (April 28, 2023); New York State Department of Financial Services, "Internal Review of the Supervision and Closure of Signature Bank," (April 28, 2023).

One challenge with the exercise of supervisory discretion is ensuring consistency, particularly across regulatory bodies. To minimize the effects of "charter shopping" by banks, federal and state banking agencies should commit to leveling up supervision and ensuring uniform and consistent standards across agencies. One of my priorities as Chair of the Federal Financial Institutions Examination Council will be getting back to basics, focusing on the Council's mission to promote uniform principles and standards in the supervision of financial institutions.

Regulations regarding the resilience and resolvability of large banks need to be strengthened. The failures of SVB and Signature Bank required the invocation of the systemic risk exception in order to avoid contagion and financial instability. Stronger resiliency requirements for large banks with regard to capital and liquidity would have reduced the probability of their failures. Stronger resolvability requirements – such as bail-in-able long-term debt to absorb losses and separability to enable rapid sales to third parties – would have facilitated orderly failures with less government involvement.[2] The OCC is working closely with the Federal Reserve and FDIC to address these issues.

Deposit insurance coverage should be updated. The recent bank turmoil has been driven in part by uncertainty about the safety of uninsured deposits. The FDIC's recent report on deposit insurance presents several options for Congressional consideration.[3] The report's analysis is worth careful consideration, especially its conclusion that expanding FDIC insurance in a targeted manner to cover business payment accounts may have the greatest potential to meet the objectives of deposit insurance and financial stability while constraining moral hazard.

An updated and properly calibrated FDIC deposit insurance system would be the most effective and efficient way to address the liquidity risk of uninsured deposits. In the meantime, we have been working with our banks, especially those with significant levels of uninsured deposits, to ensure that their cash holdings and borrowing capacity can meet depositor withdrawals. We remain committed to supervising banks so that depositors can rest assured that their money is safe.

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[2] Remarks of Acting Comptroller Michael J. Hsu before the Wharton Financial Regulation Conference 2022, "Financial Stability and Large Bank Resolvability," (April 1, 2022).

[3] FDIC, "Options for Deposit Insurance Reform" (May 1, 2023).

The diversity of the banking system must be preserved as the industry evolves. The recent turmoil has increased the market's scrutiny of regional and midsize bank business models, outlooks, and valuations. The OCC has been working on updating the analytical frameworks related to the bank merger guidelines that the federal banking agencies and Department of Justice must follow when considering bank mergers.[4] The recent turmoil has increased the urgency of these efforts. It also presents an opportunity to shape a more competitive, more community-oriented, and more resilient banking system. The OCC is committed to being open-minded when considering merger proposals and to acting in a timely manner on applications, consistent with the requirements of the Bank Merger Act.

As the industry evolves, I believe strongly that it is paramount that we preserve the diversity of the banking system, including the community banking model. Community banks—as well as regional and midsize banks—play an invaluable role in supporting the extraordinarily diverse range of economies, small businesses, and individuals across the country. I have spoken to many community, regional and midsize bankers about this and will continue to engage with them on this important priority.

Guarding Against Complacency by Banks

Two years ago, when I became Acting Comptroller, I prioritized and highlighted the need to guard against complacency.[5] Since then, I have emphasized the importance of both paying attention to tail risks and being disciplined with regards to "blocking and tackling," e.g., interest rate and credit risk management.[6]

Continued industry and regulatory vigilance is critical.[7] Elevated interest rates put pressure on banks' cost of funding. Asset-liability management practices, including liquidity and interest

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[4] The OCC hosted a symposium on bank mergers on February 10, 2023. Video of the symposium is available through the OCC's Digital Media Library.

[5] Statement of Michael J. Hsu, Acting Comptroller of the Currency, before the Committee on Banking, Housing, and Urban Affairs, United States Senate (Aug. 3, 2021); Statement of Michael J. Hsu, Acting Comptroller of the Currency, before the Committee on Financial Services, United States House of Representatives (May 19, 2021)

[6] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the RMA Risk Management Virtual Conference, "Promoting Prudent Credit Risk Management and Diversity and Inclusion," (December 5, 2022); Remarks by Acting Comptroller of the Currency Michael J. Hsu before the American Bankers Association on Tail Risks (March 31, 2022).

[7] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the Bloomberg Risk & Regulation Week 2022, "When the Tide Goes Out," (May 17, 2022).

rate risk modeling, stress testing, and sensitivity analysis, are critical risk management practices for banks. The commercial real estate market, in particular office space, is expected to experience credit strains due to higher vacancy rates and higher interest rates as loans refinance. We also expect delinquency and loss rates in the retail and mortgage space to increase from their historically low levels. Banks will need to anticipate and manage these trends and have contingency plans to mitigate adverse impacts.

To effectively guard against complacency, we must also be attentive to risks beyond the daily headlines. The OCC remains focused on risks associated with IT operations and cybersecurity, and we have encouraged banks to stay abreast of new technologies and threats. Banks need to invest appropriately to guard against these risks notwithstanding the temptation to postpone updating legacy IT systems or to defer maintenance of existing technology.[8]

In an environment of uncertainty, bank capital remains foundational. As we have seen, strong capital requirements have proven repeatedly to be a critical element of the bank regulatory framework and help to ensure that the banking industry serves as a source of strength during times of economic stress. The OCC remains committed to implementing the enhanced regulatory capital requirements that align with the final set of Basel III standards, and it is important that we move forward as soon as possible. The implementation of these standards for large banking organizations will strengthen the resilience of the domestic banking system.[9]

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.

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

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[8] Remarks of Acting Comptroller of the Currency Michael J. Hsu before the Joint Meeting of the Financial and Banking Information Infrastructure Committee and the Financial Services Sector Coordinating Council (Aug. 2, 2022).

[9] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the IIB Annual Washington Conference, "Trust and Global Banking: Lessons for Crypto," (March 6, 2023).

the system is working against them, rather than for them. The OCC is focused on several initiatives to address this problem including efforts through Project REACh – the OCC's Roundtable for Economic Access and Change – and through membership in the Property Appraisal and Valuation Equity (PAVE) task force sponsored by the Department of Housing and Urban Development. This year, the OCC also undertook efforts to focus on measuring and improving the financial health of consumers, and recently produced its second discussion in the Financial Health: Vital Signs video series focused on the importance of building assets.

The OCC has been working with the Federal Reserve and FDIC to modernize and strengthen the Community Reinvestment Act (CRA). The CRA is a critical tool for bank regulators to expand financial inclusion and opportunity for all Americans, especially the underserved. The agencies received hundreds of detailed and thoughtful comments on the Notice of Proposed Rulemaking, including from Members of this Committee, and we are working together to consider the suggestions.

In addressing inequality, I am mindful that it is expensive to live paycheck to paycheck and overdrafts can be part of that expense. While bank overdraft programs can be helpful for consumers facing short-term liquidity issues, they also present a variety of risks to consumers and to banks, including compliance, operational, reputation and credit risks. Last month, the OCC published a bulletin to provide guidance to bankers to address the risks associated with bank overdraft protection programs, identify certain practices that may result in heightened risk exposures, and describe practices that may assist banks with managing these risks.[10] The guidance also encourages banks to explore offering low-cost accounts, or other lower cost alternatives for covering overdrafts, such as overdraft lines of credit or linked accounts to consumers. The guidance furthers the agency's support for solutions that help banks meet the evolving needs of their consumers, businesses, and communities.[11]

Adapting to Digitalization

The business of banking is becoming increasingly digitalized. Technology firms are

[10] OCC Bulletin 2023-12, "Overdraft Protection Programs: Risk Management Practices" (Apr. 26, 2023).
[11] Remarks of Acting Comptroller of the Currency Michael J. Hsu at the NCRC's 2023 Just Economy Conference, "Elevating Fairness," (Mar. 30, 2023).

expanding into financial services, and bank partnerships with fintechs are now commonplace. I believe that financial technology generally, and fintech and big technology companies specifically, will warrant even more attention in the future.

On March 30, 2023, the OCC announced the establishment of an Office of Financial Technology to enhance the agency's expertise and ability to adapt to the rapid pace of technological changes in the banking industry.[12] The Office of Financial Technology broadens the OCC's focus in this area and contributes to the agency's leadership and agility in adapting to the evolution of banking services. It expands 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. The office is responsible for the analysis, evaluation and discussion of relevant trends in financial technology, emerging and potential risks, and enhancing our expertise on matters relating to digital assets, fintech partnerships, and changing technologies and business models.

We are also working closely with our interagency peers to ensure that banks appropriately manage their risks associated with third-party relationships, including relationships with financial technology companies. Banks need to be mindful that partnering with third parties does not diminish their responsibility to ensure the activity is performed in a safe and sound manner and in compliance with applicable laws. In addition, as open banking gains attention in the United States, bank regulators must prepare and engage with stakeholders to ensure that the safety, soundness, and fairness of banks' operations are maintained as consumer rights with regards to their financial data are strengthened.

Managing Climate-Related Financial Risks 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 and federal savings associations operate in a safe and sound manner. It is not our role to tell bankers who they can and cannot serve. We do not pick winners or losers, but focus on ensuring that banks understand the climate related financial risks they face and have robust risk management programs in place to control and monitor those risks.

[12] OCC News Release 2023-31, "OCC Establishes Office of Financial Technology" (Mar. 30, 2023).

The OCC continues to consider the comments received on its proposed Principles for Climate-Related Financial Risk Management for Large Banks issued in December 2021 and is working with the other banking agencies to determine next steps. Our focus is on large banks with at least $100 billion in consolidated assets because that is where the risks are most complex and material. In our work to date, we have found that most large banks have established board governance and senior management structures to address climate-related financial risks, and continue to develop processes to measure and monitor the potential exposures to those risks.

The OCC Supports Community Banks and MDIs

The safety and soundness of community banks is central to the OCC's mission, and the agency is committed to fostering an environment that allows well-managed community banks to grow and thrive.

Revitalizing of Minority Depository Institutions (MDI). 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, the number of MDIs has decreased, and they have historically faced challenges with accessing capital, adopting new technology, and modernizing their infrastructures. In July 2022, the OCC issued an updated policy statement on MDIs that reaffirms the agency's commitment to these institutions and describes the range of programs in place to support MDIs.[13] The policy statement serves to focus the agency's efforts to ensure MDIs remain a bedrock of financial access and inclusion.

Regulation Based on Size and Complexity. It is imperative that regulatory expectations for banks are differentiated based on several factors, including banks' size and complexity. We are mindful of concerns from community bankers that requirements for large banks should not trickle down to smaller banks, as such requirements can pose an undue burden and unnecessarily tie up scarce personnel and other resources. The OCC will remain diligent in guarding against such outcomes, while ensuring the federal banking system remains safe, sound, and fair. We plan to continue to engage directly with each community bank that we supervise, and our two Federal Advisory Committees, the Minority Depository Institution Advisory Committee and the Mutual

[13] Refer to OCC News Release 2022-92, "OCC Updates Policy Statement on Minority Depository Institutions" (Jul. 27, 2022).

Savings Association Advisory Committee, will continue to assist in this effort.

Conclusion

Throughout the recent financial stress, the OCC has closely monitored the conditions of the national banks and federal savings associations we regulate. We have reviewed the recent reports issued by our peer regulators. We are continually evaluating our approach to supervision to ensure it remains effective and properly calibrated.

At the same time, the OCC has made progress advancing several priority areas. The federal banking system remains a source of strength to the U.S. economy and the institutions we regulate remain prepared to serve their customers, businesses, and communities in a safe, sound, and fair manner.

Timeline of Silicon Valley Bank Failure

- 2018: Congress approves the "Economic Growth, Regulatory Relief, and Consumer Protection Act," raising from $50 billion to $250 billion the level of assets a bank must have to face "enhanced supervision" with more "stringent standards." SVB assets are $57 billion.
- **2021: Bonus for SVB CEO Gary Becker, based on return on equity (i.e., net income), results in compensation nearly three times his salary. SVB assets are $211 billion.**
- April 2022: SVB chief risk officer Laura Izurieta departs bank with $7 million in compensation (stock option gains). She is not replaced for eight months.
- **2022: SVB unwinds more than $14 billion in interest rates swaps (hedging against rising interest rates) over the course of the year, resulting in more than $500 million in gains in the first two quarters alone.[1] Company reports 2022 net income of $1.5 billion (down from 2021, but would likely have been a loss without termination of hedge).**
- **Late Jan, 2023: SVB CEO and others change 10b5-1 plans, providing for stock sales. (A new SEC rule, which isn't in effect as of this date, prohibits sales following a new 10b5-1 plan for six months.)**
- **Feb 27, 2023: Gary Becker sells $3 million+ worth of stock, netting $2.2 million.**
- **March 8: SVB announces it will raise capital.**
- March 9, 2023: bank run.
- March 10: FDIC takes over SVB. Stock price goes to zero.

Source: Adapted from Bartlett Naylor, Public Citizen

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[1] Robin Wigglesworth, "How crazy was Silicon Valley Bank's zero-hedge strategy?" Financial Times, March 17, 2023, https://www.ft.com/content/f9a3adce-1559-4f66-b172-cd45a9fa09d6.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Patrick McHenry
Chairman
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Chairman McHenry:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Chairman Patrick McHenry:

1. **Who is the principal author of the SVB failure review that you led, and who were the contributing authors?**

A former head of supervision from the Federal Reserve Bank of New York led the report drafting. The team included experienced professionals, who were not involved in the supervision of Silicon Valley Bank.

2. **For corroboration purposes, will you supply the House Committee on Financial Services the sample size of Federal Reserve staff surveyed for an assessment of "culture" in supervision and regulation in the review that you led of SVB's failure and supervision, sample selection criteria, and names of those who participated in the survey? Will you supply the questions posed to staff in the survey?**

Board staff have worked cooperatively with House Financial Services Committee staff to produce information related to the SVB review. On June 15, 2023, Board staff held a call with Committee staff to share details and responded to questions from Committee staff about the information collected as a part of the review. Board staff would be glad to follow-up with Committee staff if there are outstanding questions related to the review.

3. **Will you commit to providing the House Financial Services Committee with quantitative analyses of effects of the Basel III endgame reforms that you appear to remain committed to implementing, and to provide the Committee ample time to review the analysis?**

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[1] The proposal, which would implement the final components of the Basel III agreement, will go through the normal notice and public comment process, which includes an explanation of the proposed changes and potential impacts, as well as opportunity for comment.

To further refine estimates of the potential impact, the Board is collecting data additional data from the banks affected by the proposal.[2] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public. The agencies have also extended the comment period on the proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments.[3]

4. **You included in an open cover letter to the review of SVB that you led, your personal takeaways from the review.**

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[1] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.
[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[3] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

a. In advance of the public release of the SVB review that you led, on what date and time of day did other Fed Board members receive a copy of the SVB review?

b. Did they have the opportunity to comment or promote feedback?

The SVB report was led by me and was not a report of the Board. The Chair and other Board members were provided a copy of the report after it was largely finalized but before its public release. I routinely have discussions with my fellow board members on supervision and regulatory matters, including key takeaways from the SVB report, and I look forward to engaging with them on subsequent reforms.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Andy Barr
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Washington, D.C. 20515

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Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Andy Barr:

1. **Numerous countries who are members of the Basel Committee have completed their implementation of the 2017 standard commonly referred to as the "Basel III End-Game." Other countries, while not having completed implementation, have taken steps that would be the equivalent of a proposed regulation in the United States. I have two requests in the form of questions:**

    a. **First, for each of those countries, whether proposed or final, will you provide the Committee with a detailed assessment of deviations for any particular component of the standard on a country-by-country basis?**

    b. **Second, in providing such information, will you please include all deviations, regardless of how narrow, and provide the information to the Committee prior to release of a Notice or Proposed Rulemaking to implement the standard in the US?**

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[2] The proposal, which would implement the final components of the Basel III agreement, will go through the normal notice and public comment process, which includes an explanation of the proposed changes and potential impacts, as well as opportunity for comment.

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International comparisons can be difficult due to differences in jurisdictions, but we are closely monitoring how other countries are implementing Basel III.

2. **The SVB review that you led discusses a draft informal enforcement action that was being contemplated against SVB.**

    a. **When did the Federal Reserve Bank of San Francisco make the recommendation to the Board staff?**

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[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.
[3] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[4] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

b. Were staff at the Federal Reserve Bank of San Francisco given any feedback regarding whether additional exam work needed to be conducted, either formally or informally, by Board staff prior to making the recommendation?

Federal Reserve Bank of San Francisco (FRBSF) discussed an informal enforcement action with Board staff during the Governance and Risk Management Target examination in May 2022[5] and made the formal recommendation following the completion of that review in July 2022.

3. The SVB review that you led discusses a "shift in culture," and implies that such a shift should be blamed on former Vice Chairman for Supervision Quarles. Please explain how this Committee can validate or reject the claim?

In the interviews for the Silicon Valley Bank (SVB) report, staff repeatedly mentioned changes in expectations and practices, including pressure to reduce burden on firms, meet a higher burden of proof for a supervisory conclusion, and demonstrate due process when considering supervisory actions. There was no formal or specific policy that required this, but staff reported a shift in culture and expectations from internal discussions and observed behavior that changed how supervision was executed. As a result, staff approached supervisory messages, particularly supervisory findings and enforcement actions, with a need to accumulate more evidence than in the past, which contributed to delays and in some cases led staff not to take action.

4. What, specifically, does your "holistic review" entail, what areas of supervision are covered, what metrics have you used for whatever has been your analysis, and will you provide your analysis to Members of the House Committee on Financial Services?

When I arrived at the Federal Reserve, I initiated a review of our capital tools to understand how they support the resilience of the financial system, individually and in combination. This is a prudent first step for any Vice Chair for Supervision, and consistent with the actions taken by my predecessor. My holistic capital review focused on whether changes to capital requirements for large banks with more than $100 billion in assets would be appropriate to better align capital requirements with risk-taking to help ensure that our banking system is sufficiently resilient to serve its vital role in our economy. Since capital requirements are multi-layered with different components, it was important to take a holistic approach because the requirements function as a system – each component treats risks and associated capital needs differently, but all components together result in a certain amount of capital required.

During the review, I engaged with a wide range of parties: policymakers and staff from the Federal Reserve and other agencies, banks and financial sector groups, public interest groups, members of Congress, and academics to get a broad perspective on how the Federal Reserve's capital standards interact with each other and the result they together achieve.

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[5] *See* https://www.federalreserve.gov/supervisionreg/files/svbfg-and-svb-governance-and-risk-management-target-supervisory-letter-20220531.pdf.

As part of the review, I looked at risk-based capital requirements, the stress capital buffer, the G-SIB surcharge, the counter cyclical capital buffer, the enhanced supplementary leverage ratio, and long-term debt requirements. My conclusions are detailed in my recent speech.[6]

5. You have stated your desire to conduct a holistic review of capital and your commitment to propose rules implementing the final Basel III reforms. How will you engage with policymakers, industry stakeholders, and the public to provide full transparency as to your regulatory response before we see any regulatory proposals?

Soliciting public input is a critical part of our rulemaking process. As noted in my response to question 1, the agencies have extended the comment period on their proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments. To further refine estimates of the potential impact, the Board will collect data additional data from the banks affected by the proposal.[7] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public.

6. In November you testified before the House Committee on Financial Services that you were also reviewing the G-SIB surcharge, the enhanced supplementary leverage ratio, stress testing, the countercyclical capital buffer, and other regulatory requirements. Is the Federal Reserve Board planning to revisit these other items as part of the holistic review, Basel III endgame NPR, or subsequent rulemakings, and what involvement will you be allowing for the full Board of Governors, Congress, and the American people?

We are in the process of conducting a holistic review of our capital framework to ensure that all of our requirements are appropriately supporting the resilience of the financial system, and to assess whether the regulatory framework can be made more effective. We will also continue to evaluate the resiliency of banks and monitor financial and economic conditions to ensure our capital framework functions as intended. Soliciting public input is a critical part of our process as we consider any potential adjustments to the capital framework. Any rule changes that might be proposed as a result of the review would go through the normal notice and public comment process, which includes explaining the basis for the proposed changes, and would be subject to a vote by the Board.

7. Former Vice Chairman for Supervision Quarles has argued that, rather than promoting some sort of loose "culture" as your report suggests, he focused sharply on assessing risk and ensuring that there was factual support for supervisory actions, the very sort of fairness and priority setting that we should expect from bank supervisors rather than promoting some sort of loose "culture" as your report suggests. Do you agree with the former Vice Chairman's argument about his objectives?

Please see my response to question 3.

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[6] *See* https://www.federalreserve.gov/newsevents/speech/barr20230710a.htm.
[7] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.

8. The SVB and Signature Bank failures had multiple contributing factors, including: failure of bank management; failure of state and federal supervisors and examiners; inattention to the most rapid interest rate increases in modern history because the Fed was behind the curve in waking up to runaway inflation caused by reckless federal spending; and failure of the Fed to pay attention to interest rate risks caused by the Fed's delayed monetary policy response. The recent reports by federal and state regulators affirm that bank executives and your supervisors failed, but instead of ensuring that your house is in order, you attempt to use these failures as a reason to argue for additional authorities and stricter regulations, including increasing bank capital levels.

In fact, your own report on SVB states that, "While higher supervisory and regulatory requirements may not have prevented the firm's failure, they would likely have bolstered the resilience of Silicon Valley Bank."

You, Chairman Powell, Secretary Yellen, and many others have repeatedly stated that banks are well capitalized, and the banking system is resilient.
If that is the case, why do you believe it is necessary to impose additional regulation and punish the many well-run financial institutions who had nothing to do with creating recent instability for bank runs that began with these unique bank and supervisory failures?

SVB's failure has emphasized why strong bank capital matters, in addition to strong liquidity requirements. While the proximate cause of SVB's failure was a liquidity run, the underlying issue was concern about its solvency. Further, the potential contagion that followed the failure of SVB suggests that probability of default and loss given default may be greater than we previously thought, suggesting that additional resilience may be needed.

As risks in the financial system continue to evolve, we need to continuously evaluate our supervisory and regulatory framework. The risks driving the next stress event may not be-and likely will not be-the same as those in the last one. That is why we need to bolster resiliency broadly in the financial system, including through stronger capital requirements.

9. I understand that only one analyst at the Board was chiefly responsible for covering SVB, along with some other similarly sized banks. How many analysts at the Board are currently assigned to climate-related supervision projects?

The Federal Reserve established the Supervision Climate Committee (SCC) to strengthen our capacity to identify and assess financial risks from climate change and to develop an appropriate program to ensure the resilience of our supervised firms to those risks. The SCC is supported by a small number of staff on a full-time basis, and other Federal Reserve System employees may also devote a small fraction of their time to projects relating to climate-related financial risks.

10. Is there a threshold for bank asset size below which you would be comfortable that a deposit run on the bank would not be ignited?

Between March and May 2023, SVB, Signature Bank, and First Republic Bank failed following substantial deposit outflows prompted by concerns over poor management of interest rate risk and liquidity risk, as well as concerns around high levels of uninsured deposits. Generally, smaller banks have lower levels of uninsured deposits, which reduces the risk of deposit runs driven by this factor.

11. Is there a threshold for bank asset size below which you would be comfortable saying that failure of the bank would not lead with any positive probability to instability in the U.S. financial system?

Asset size is not the only factor that determines a bank's systemic importance; the Board also considers a firm's interconnectedness, complexity, substitutability, cross-border operations, and business concentration, among other factors, when considering systemic risks. In addition, a firm's distress may reveal novel information about vulnerabilities in the financial system and have systemic consequences through contagion, even if the firm is not large or interconnected.

12. SVB was well capitalized before its failure, and it ran into rapid deposit flight—a bank run. How can such an event possibly reinforce your perceived need to implement so-called Basel III endgame reforms or whatever will be the results of your own personal "holistic" review of capital standards?

While the proximate cause of SVB's failure was a liquidity run, depositors fled because they did not think the firm had enough capital. The firm failed to hedge its exposure to rising interest rates, which led to a large potential loss on its balance sheet. More capital could have helped mitigate the risk that these losses would lead to insolvency. The firm also had a highly concentrated and highly unstable funding profile, which hastened the run that led to the timing of its failure. Without the initial solvency concern, however, it is unclear that its depositors would have run from the firm. And once SVB failed, the potential contagion that followed suggests that probability of default and loss given default may be greater than we previously thought.

Recent events have reinforced that robust capital is fundamental to the strength and stability of our financial system. Well-capitalized banks have the capacity to support the economy by continuing to lend to households and businesses through stressful conditions. Thus, strong capital requirements can help ensure that banks maintain lending during economic downturns. The Basel III reforms are intended to produce more robust and internationally consistent capital requirements for the largest firms, building on the initial set of improvements made to the capital framework following the 2007-09 financial crisis.

13. How much involvement has there been of other members of the Board of Governors of the Federal Reserve System in your Basel III endgame reform analysis and in your holistic review of capital standards?

I routinely have discussions with my fellow Board members on supervision and regulatory matters, including the holistic review of capital standards and Basel III reforms.

14. By comparison, how much involvement has there been on the part of your "counterparts" at the FDIC and OCC?

The Board is working with the Federal Deposit Insurance Corporation and Office of Comptroller of the Currency to implement the Basel III reforms in the United States and other revisions to the capital framework that are appropriate for the U.S. market. I keep my fellow Board members apprised of the status of those discussions.

15. You have stated that you are forming a dedicated novel activity supervisory group at the Board. Yet the issues identified in your report on SVB's failure are basic, well-known banking risks.

a. How would a novel activity supervisory group have helped prevent a bank run?

b. Please explain in detail who is in your novel group and what it is charged to do?

c. Will staff be reassigned from existing work streams to instead work for your novel group, or will you be hiring new staff?

The Federal Reserve has established a Novel Activities Supervision Program (program) to enhance the supervision of novel activities conducted by banking organizations supervised by the Federal Reserve. The program will focus on novel activities related to crypto-assets, distributed ledger technology, and complex, technology-driven partnerships with nonbanks to deliver financial services to customers. The program will be risk-focused and complement existing supervisory processes, strengthening the oversight of novel activities conducted by supervised banking organizations.

Financial innovation supported by new technologies can benefit the U.S. economy and U.S. consumers by spurring competition, reducing costs, creating products that better meet customer needs, and extending the reach of financial services and products to those typically underserved. However, the benefits of innovation can only be realized if appropriate guardrails are in place. Innovation can lead to rapid change in individual banks or in the financial system and generate risks that are not well-addressed by existing regulations and supervisory approaches. For example, we seen that business models focused on novel activities can generate concentrated exposure to particular industries or markets, leading to elevated risks of losses or runs. The program is intended help address these risks before they build up and to help supervisors understand novel industry and market dynamics.

Firms of all sizes are actively engaging in novel activities and the program is intended to strengthen the supervision of novel activities for all Federal Reserve-supervised banking organizations. Importantly, the program will work through the existing supervisory portfolios and supervisory teams and will look to leverage existing supervisory processes to the extent possible to maximize efficiency and minimize burden. This hybrid model keeps overall responsibility for the supervision of individual firms intact at their existing Reserve Bank, while

also establishing a dedicated program that will analyze, monitor, and examine firms engaged in novel activities.

Staffing for the program will be comprised of a hybrid model of staff from both the Board and all twelve Reserve Banks. Existing staff with institutional knowledge will be reallocated and complemented by new staff members as needed.

16. Will increasing capital requirements on regional banks constrain their ability to provide credit to the consumers and businesses and contribute to a growing credit crunch and possible future recession?

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[8]

The vast majority of banks in the country would not be subject to the recent proposal on bank capital. The proposal affects only the very largest banks—less than 40 of more than 4,000 banks in the system.

For the largest banks, as you noted, the proposal is projected to raise capital requirements, which may result in higher funding costs. But this is only half the story. As we indicated in the preamble to our capital proposal, historical experience—particularly our experience during the Global Financial Crisis—demonstrates the severe impact that distress or failure at individual banking organizations can have on the stability of the U.S. banking system. Fifteen years ago, the Global Financial Crisis starkly revealed the cost to society of a banking system that had insufficient capital. In the lead-up to the financial crisis, the rules didn't fully capture the risks of asset classes like subprime mortgages, securitizations, and derivatives, which led to enormous losses at banks. Banks were woefully undercapitalized for these losses. The financial crisis upended lives and did severe damage to the economy, causing the worst and longest recession since the Great Depression. It took six years for employment to recover, during which time long-term unemployment ran for long periods at a record high, and more than 10 million people fell into poverty. Six million families lost their homes to foreclosure. And these costs occurred even with an unprecedentedly large response by government.

The effective rise in capital requirements related to lending activities in the current proposal is a small portion of the estimated overall capital increase. The bulk of the rise in required capital anticipated in the proposed rule is attributed to trading and other activities besides lending—activities that have generated outsized losses at large banks and areas where our current rules have shortcomings.

Over the last several months, I have engaged with a wide range of parties: policymakers and staff from the Federal Reserve and other agencies, banks and financial sector groups, public interest groups, members of Congress, and academics to get a broad perspective on how the Federal

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[8] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.

Reserve's capital standards interact with each other and the result they together achieve. And with the issuance of the agencies' proposal, I look forward to the public comment process.

To further refine estimates of the potential impact, the Board will collect data additional data from the banks affected by the proposal.[9] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public. The agencies have also extended the comment period on the proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments.[10]

Finally, it is important to note that the proposal contemplates an effective date of July 1, 2025, for the proposed changes, with an extended transition period—so the changes will not be effective for some time. The Board implements regulatory changes through a notice-and-comment process, and generally allows for phase-in periods that allow for a gradual introduction of the new rules.

This phase-in will allow ample time for banks to adjust their balance sheets and activities, and to build capital over time. In fact, most banks already have enough capital today to meet the proposed requirements. For the banks that would need to build capital to meet the proposed requirements, assuming that they continue to earn money at the same rate as in recent years, we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their dividends.

17. In your cover letter accompanying the SVB review you stated, "this experience has emphasized why strong bank capital matters," and that moving forward with Basel III endgame rules would bolster resiliency in the financial system.

What do the final Basel III standards have to do with the failure of the management and supervision of Silicon Valley Bank and bank-run psychology?

Please see my response to question 8.

18. Since being confirmed, you have been focused on capital levels, with most speculating increases are imminent. For the record, capital was not the root cause of the failure of SVB or Signature Bank and would not have saved the failed banks from management failures, supervisory failures, and certainly not bank runs. Despite this, you stated in the executive summary of your report that, "this experience has emphasized why strong bank capital matters." In the face of a growing credit crunch, and continued economic uncertainty, will you commit to taking time to allow Congress, the full Board of Governors, and the American people to see whatever analyses and reviews you have been performing before you hastily rush toward more and more regulation and job killing capital requirements?

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[9] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[10] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

Any proposed changes to capital requirements would go through the notice and public comment process, which includes explaining the basis for the proposed changes, and would be subject to a vote by the Board.

19. In a recent report titled "Basel III Endgame: The Next Generation of Capital Requirements," PwC stated that the average optimal capital level is near current levels at firms expected to be subject to Basel III Endgame capital requirements, with an average of 15.5%. The report goes on to demonstrate that this figure aligns closely with the actual average tier 1 bank capital ratios for bank holding companies that are expected to be subject to Basel III Endgame capital requirements.

a. Do you agree with PwC's assessment?

b. If not, what do you believe the optimal levels should be, and on the basis of what analysis?

c. Will you commit to releasing the Federal Reserve's analysis?

The existing body of empirical and theoretical research provides a wide range of estimates for optimal bank capital levels. While the estimates vary widely, and are highly contingent on the assumptions made, the current U.S. bank capital requirements are toward the lower end of the range described in most of the research literature.

Capital should be sufficient to enable banks to absorb unexpected losses and continue operations through severely stressful but plausible events. As with any proposed rule of this materiality, the Board will include an economic impact analysis as part of the preamble of any final rule.

20. The Federal Reserve Board announced last year it would conduct a scenario analysis pilot to better assess the long-term, climate-related financial risks facing the largest institutions. Would you please expand on this pilot exercise, including what information is being requested and maintained by the Fed and why the exercise asks banks to hypothetically fix its portfolio for a long period of time, even though it would never do so, to capture hypothetical effects of weather and climate changes?

a. Does the Fed not already have access to the information it is requesting the banks provide through regular examinations?

b. The announcement of your climate scenario analysis stated the participating banks will not face "capital or supervisory implications from the pilot." What does the Fed plan to do next after it gathers results of its climate experiment and publishes whatever you think the results show?

c. How many climate specialists are on staff at the Federal Reserve and what are their backgrounds?

The Federal Reserve's pilot climate scenario analysis exercise is designed to obtain information about large banking organizations' climate risk-management practices and challenges and to enhance the ability of both large banking organizations and supervisors to identify, measure, monitor, and manage climate-related financial risks. Participating large banking organizations are asked to estimate the effect of hypothetical climate scenarios on a relevant subset of their loan portfolios over a future time horizon. For each loan, participants are asked to calculate and report to the Federal Reserve credit risk parameters, such as probability of default, internal risk rating grade, and loss given default, as appropriate. Participants are also asked to respond to qualitative questions describing their governance, risk-management practices, measurement methodologies, results for specific portfolios, and lessons learned. The Federal Reserve does not have access to this specific information through its regular examinations of large banking organizations.

Participating large banking organizations are asked to assume that their balance sheets remain static over the relevant projection horizon for purposes of the pilot climate scenario analysis exercise in order to allow participants to focus on risk measurement, rather than on forecasting how business strategies and balance sheets could evolve over time.

The pilot climate scenario analysis exercise is an exploratory exercise to better understand how large banking organizations are assessing climate-related financial risks and will not have capital or supervisory consequences. The Federal Reserve's responsibilities with respect to climate are important but narrow, and they are closely linked to our responsibilities for bank supervision and financial stability.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 2, 2023

The Honorable Warren Davidson
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

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[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Warren Davidson:

1. **I am following up on the questions that were asked of you at the hearing. It appears that the Federal Reserve has extended this program to foreign institutions, but unfortunately, has excluded 103 credit unions in the U.S. and 43 in Ohio, serving approximately 159,000 Ohio citizens. These credit unions are state-chartered, but insured privately as allowed by the Federal Credit Union Act. I would encourage you to extend this program to these credit unions. Can you explain, however, why foreign institutions have priority over a small group of credit unions serving firefighters, police, teachers, municipal workers and small businesses here in the U.S.?**

On March 12, the Federal Reserve Board (Board) authorized each of the twelve Federal Reserve Banks to establish the Bank Term Funding Program (BTFP) in order to provide secured term lending to federally regulated depository institutions that pledge eligible collateral. The BTFP is intended to help ensure that federally regulated depository institutions (a category that includes U.S. branches and agencies of foreign banks) have the ability to meet the needs of all their depositors, and it serves as an additional source of liquidity against high-quality securities, eliminating a depository institution's need to quickly sell those securities in times of stress.

The specific features of programs authorized under section 13(3) of the Federal Reserve Act, vary, but all such programs must meet the criteria set out in statute. Among other requirements, the statute mandates that the lending Reserve Bank be secured to its satisfaction,[1] and that policies and procedures be designed to protect taxpayers from losses.[2] The BTFP was launched following the failures of Silicon Valley Bank and Signature Bank, which led to substantial outflows at certain other federally regulated depository institutions. Accordingly, the terms of the BTFP address liquidity concerns at federally regulated depository institutions.

We are continuously monitoring financial markets in case any additional pressures emerge. Privately insured credit unions that are in sound financial condition are generally eligible to obtain liquidity through the Federal Reserve's discount window.

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[1] *See* 12 U.S.C. § 343(3)(A).
[2] *See* 12 U.S.C. § 343(3)(B)(i).

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 2, 2023

The Honorable Byron Donalds
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed is my response to the question you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Question for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Byron Donalds:

1. **FedNow, set to launch in July, is a crucial step forward in ensuring Americans have faster payments. However, the current regulatory framework would leave nonbanks out from accessing FedNow directly, gatekeeping faster payments from the 82% of consumers who use nonbank financial services. Other countries, as recommended by global leaders including the BIS and World Bank, have created "settlement accounts" to address this issue and improve payments origination and settlement. The Fed still only offers a master account. Should we consider a model, like every other G7 country? Why haven't we?**

As outlined in the Board's Guidelines for Evaluating Account and Services Requests, the Federal Reserve Banks' ability to offer master accounts and access to payment services is determined by law. Unless otherwise specified by federal statute, only those entities that are member banks or meet the definition of a depository institution under section 19(b) of the Federal Reserve Act are legally eligible to obtain access to Federal Reserve accounts and financial services.

In evaluating requests for access, Reserve Banks consider a set of risk-based principles when making a determination to grant or deny a particular request by an eligible institution. These principles provide additional clarity on the level of due diligence and scrutiny that Reserve Banks will apply to different types of institutions with varying degrees of risk. For example, institutions with federal deposit insurance are subject to a more streamlined level of review, while institutions that engage in novel activities and for which authorities are still developing appropriate supervisory and regulatory frameworks undergo a more extensive review.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Andrew Garbarino
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Andrew Garbarino:

1. **Recent reports show that the Basel III revisions proposal could result in a 20 percent increase in capital levels for the largest banks, marking arguably the most comprehensive overhaul of the regulatory framework that industry would only have a few years to comply with. According to academic literature by the Basel Committee on Banking Supervision, a 1-percentage-point increase in capital requirements could potentially reduce annual GDP by up to 16 basis points, showing that higher capital requirements come at a cost and could have a significant impact on the U.S. economy.**

   Vice Chair Barr - what impact on lending and the real economy do you think such swift and strident requirements will have, and how are you controlling this?

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[1]

We recognize the importance of small businesses in the U.S. economy, and that banks are an important provider of financial services to smaller services.

First, I would note that smaller banks are a significant source of funding for small businesses and smaller banks would not be subject to this proposal. The proposal affects only the very largest banks – less than 40 of more than 4,000 banks in the system.

For the largest banks, as you noted, the proposal is projected to raise capital requirements, which may result in higher funding costs. But this is only half the story. As we indicated in the preamble to our capital proposal, historical experience—particularly our experience during the Global Financial Crisis—demonstrates the severe impact that distress or failure at individual banking organizations can have on the stability of the U.S. banking system. Fifteen years ago, the Global Financial Crisis starkly revealed the cost to society of a banking system that had insufficient capital. In the lead-up to the financial crisis, the rules didn't fully capture the of asset classes like subprime mortgages, securitizations, and derivatives, which led to enormous losses at banks. Banks were woefully undercapitalized for these losses. The financial crisis upended lives and did severe damage to the economy, causing the worst and longest recession since the Great Depression. It took six years for employment to recover, during which time long-term unemployment ran for long periods at a record high, and more than 10 million people fell into poverty. Six million families lost their homes to foreclosure. And these costs occurred even with an unprecedentedly large response by government.

The effective rise in capital requirements related to lending activities in the current proposal is a small portion of the estimated overall capital increase. The bulk of the rise in required capital anticipated in the proposed rule is attributed to trading and other activities besides lending—

[1] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.

activities that have generated outsized losses at large banks and areas where our current rules have shortcomings.

For lending to small businesses, the proposal would introduce a more risk-sensitive standardized approach that would allow some loans to qualify for lower risk weights. Small business lending tends to entail limited individual exposures spread across a diversified set of borrowers or to be secured by real estate. Our impact analysis indicates that small business loans meeting either of these criteria would generally have flat or slightly lower capital requirements, inclusive of the operational risk requirement. Loans not meeting these criteria, generally meaning a particularly large loan to a small business, would continue to be classified as a corporate exposure. Such loans would see a small increase in required capital. Therefore, we do not expect negative impacts on lending to small businesses.

Over the last several months, I have engaged with a wide range of parties: policymakers and staff from the Federal Reserve and other agencies, banks and financial sector groups, public interest groups, members of Congress, and academics to get a broad perspective on how the Federal Reserve's capital standards interact with each other and the result they together achieve. And with the issuance of the agencies' proposal, I look forward to the public comment process.

To further refine estimates of the potential impact, the Board will collect additional data from the banks affected by the proposal.[2] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public. The agencies have also extended the comment period on the proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments.[3]

Finally, it is important to note that the proposal contemplates an effective date of July 1, 2025, for the proposed changes, with an extended transition period—so the changes will not be effective for some time. The Board implements regulatory changes through a notice-and-comment process, and generally allows for phase-in periods that allow for a gradual introduction of the new rules.

This phase-in will allow ample time for banks to adjust their balance sheets and activities, and to build capital over time. In fact, most banks already have enough capital today to meet the proposed requirements. For the banks that would need to build capital to meet the proposed requirements, assuming that they continue to earn money at the same rate as in recent years, we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their dividends.

2. **You said during last month's Silicon Valley Bank (SVB) hearings that SVB was the result of bank mismanagement, failed supervision, and a Twitter-fuelled run. For the record, capital would not have mattered in this case, yet you doubled down and mentioned finalizing capital proposals as a key priority. In the face of continued economic uncertainty, we need to be very careful not to conflate a liquidity-driven event marked by management failures and supervisory shortcomings with capital adequacy**

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[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[3] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

at our banks. In your opinion, what amount of capital would have prevented SVB's collapse?

While the proximate cause of SVB's failure was a liquidity run, depositors fled because they did not think the firm had enough capital. The firm failed to hedge its exposure to rising interest rates, which led to a large potential loss on its balance sheet. More capital could have helped mitigate the risk that these losses would lead to insolvency. The firm also had a highly concentrated and highly unstable funding profile, which hastened the run that led to the timing of its failure. Without the initial solvency concern, however, it is unclear that its depositors would have run from the firm. SVB's failure has reinforced why strong bank capital matters.

Recent events have reinforced that robust capital is fundamental to the strength and stability of our financial system. Well-capitalized banks have the capacity to support the economy by continuing to lend to households and businesses through stressful conditions. Thus, strong capital requirements can help ensure that banks maintain lending during economic downturns. The Basel III reforms are intended to produce more robust and internationally consistent capital requirements for the largest firms, building on the initial set of improvements made to the capital framework following the 2007-09 financial crisis.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Mike Lawler
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Mike Lawler:

1. **Vice Chairman Barr, we understand that only one analyst at the Board was chiefly responsible for covering SVB, along with some other similarly sized banks. How many analysts at the Board are currently assigned to climate-related supervision projects?**

The Federal Reserve established the Supervision Climate Committee (SCC) to strengthen our capacity to identify and assess financial risks from climate change and to develop an appropriate program to ensure the resilience of our supervised firms to those risks. The SCC is supported by a small number of staff on a full-time basis, and other Federal Reserve System employees may also devote a small fraction of their time to projects relating to climate-related financial risks.

2. **Vice Chairman Barr, the SVB and Signature Bank collapses had multiple contributing factors, including: failure of bank management; failure of state and federal examiners; inattention to the most rapid interest rate increases in modern history because the Fed was behind the curve in waking up to runaway inflation caused by reckless federal spending; and failure of the Fed to pay attention to interest rate risks caused by the Fed's delayed monetary policy response. The recent reports affirm that bank executives and your supervisors failed, but instead of ensuring that your house is in order, you attempt to use these failures as a reason to argue for additional authorities and stricter regulations, including increasing bank capital levels.**

   In fact, your own report on SVB states that, "While higher supervisory and regulatory requirements may not have prevented the firm's failure, they would likely have bolstered the resilience of Silicon Valley Bank." You, Chairman Powell, Secretary Yellen, and many others have repeatedly stated that banks are well capitalized, and the banking system is resilient.

   a. **If that is the case, why do you believe it is necessary to impose additional regulation and punish the many well-run financial institutions who had nothing to do with creating recent instability for bank runs that began with these unique bank and supervisory failures?**

   b. **Will increasing capital requirements on regional banks constrain their ability to provide credit to the consumers and businesses and contribute to a growing credit crunch?**

   c. **Main Street businesses rely on banks to support their growth and research has shown more stringent bank regulations make bank credit more expensive for borrowers. In an already-fragile economy, with a growing credit crunch, and ongoing banking-sector stress, do you believe that increasing borrowing costs is a good thing? Have you engaged with small business stakeholders to fully understand the impact the conclusions of your review will have on them?**

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[1]

We recognize the importance of small businesses in the U.S. economy, and that banks are an important provider of financial services to smaller services.

First, I would note that smaller banks are a significant source of funding for small businesses and smaller banks would not be subject to this proposal. The proposal affects only the very largest banks – less than 40 of more than 4,000 banks in the system.

For the largest banks, as you noted, the proposal is projected to raise capital requirements, which may result in higher funding costs. But this is only half the story. As we indicated in the preamble to our capital proposal, historical experience—particularly our experience during the Global Financial Crisis—demonstrates the severe impact that distress or failure at individual banking organizations can have on the stability of the U.S. banking system. Fifteen years ago, the Global Financial Crisis starkly revealed the cost to society of a banking system that had insufficient capital. In the lead-up to the financial crisis, the rules didn't fully capture the risks of asset classes like subprime mortgages, securitizations, and derivatives, which led to enormous losses at banks. Banks were woefully undercapitalized for these losses. The financial crisis upended lives and did severe damage to the economy, causing the worst and longest recession since the Great Depression. It took six years for employment to recover, during which time long-term unemployment ran for long periods at a record high, and more than 10 million people fell into poverty. Six million families lost their homes to foreclosure. And these costs occurred even with an unprecedentedly large response by government.

The effective rise in capital requirements related to lending activities in the current proposal is a small portion of the estimated overall capital increase. The bulk of the rise in required capital anticipated in the proposed rule is attributed to trading and other activities besides lending—activities that have generated outsized losses at large banks and areas where our current rules have shortcomings.

For lending to small businesses, the proposal would introduce a more risk-sensitive standardized approach that would allow some loans to qualify for lower risk weights. Small business lending tends to entail limited individual exposures spread across a diversified set of borrowers or to be secured by real estate. Our impact analysis indicates that small business loans meeting either of these criteria would generally have flat or slightly lower capital requirements, inclusive of the operational risk requirement. Loans not meeting these criteria, generally meaning a particularly large loan to a small business, would continue to be classified as a corporate exposure. Such loans would see a small increase in required capital. Therefore, we do not expect negative impacts on lending to small businesses.

Over the last several months, I have engaged with a wide range of parties: policymakers and staff from the Federal Reserve and other agencies, banks and financial sector groups, public interest

[1] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.

groups, members of Congress, and academics to get a broad perspective on how the Federal Reserve's capital standards interact with each other and the result they together achieve. And with the issuance of the agencies' proposal, I look forward to the public comment process.

To further refine estimates of the potential impact, the Board will collect additional data from the banks affected by the proposal.[2] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public. The agencies have also extended the comment period on the proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments.[3]

Finally, it is important to note that the proposal contemplates an effective date of July 1, 2025, for the proposed changes, with an extended transition period—so the changes will not be effective for some time. The Board implements regulatory changes through a notice-and-comment process, and generally allows for phase-in periods that allow for a gradual introduction of the new rules.

This phase-in will allow ample time for banks to adjust their balance sheets and activities, and to build capital over time. In fact, most banks already have enough capital today to meet the proposed requirements. For the banks that would need to build capital to meet the proposed requirements, assuming that they continue to earn money at the same rate as in recent years, we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their dividends.

3. **Vice Chairman Barr, you have stated that you are forming a dedicated novel activity supervisory group at the Board. Yet the issues identified in your report are basic, well-known banking risks. How would a novel activity supervisory group have helped prevent a SVB bank run? Please explain in detail who is in your novel group and what it is charged to do? Will staff be pulled off existing work streams to instead work for your novel group, or will you be hiring new staff?**

The Federal Reserve has established a Novel Activities Supervision Program (program) to enhance the supervision of novel activities conducted by banking organizations supervised by the Federal Reserve. The program will focus on novel activities related to crypto-assets, distributed ledger technology, and complex, technology-driven partnerships with nonbanks to deliver financial services to customers. The program will be risk-focused and complement existing supervisory processes, strengthening the oversight of novel activities conducted by supervised banking organizations.

Financial innovation supported by new technologies can benefit the U.S. economy and U.S. consumers by spurring competition, reducing costs, creating products that better meet customer needs, and extending the reach of financial services and products to those typically underserved. However, the benefits of innovation can only be realized if appropriate guardrails are in place. Innovation can lead to rapid change in individual banks or in the financial system and generate risks that are not well-addressed by existing regulations and supervisory approaches.

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[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[3] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

We saw that business models focused on novel activities can generate concentrated exposure to particular industries or markets, leading to elevated risks of losses or runs. The program is intended help address these risks before they build up and to help supervisors understand novel industry and market dynamics.

Firms of all sizes are actively engaging in novel activities and the program is intended to strengthen the supervision of novel activities for all Federal Reserve-supervised banking organizations. Importantly, the program will work through the existing supervisory portfolios and supervisory teams and will look to leverage existing supervisory processes to the extent possible to maximize efficiency and minimize burden. This hybrid model keeps overall responsibility for the supervision of individual firms intact at their existing Reserve Bank, while also establishing a dedicated program that will analyze, monitor, and examine firms engaged in novel activities.

Staffing for the program will be comprised of a hybrid model of staff from both the Board of Governors and all twelve Reserve Banks. Existing staff members with institutional knowledge will be reallocated and complemented by new staff members as needed.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 2, 2023

The Honorable Frank D. Lucas
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Frank D. Lucas:

1. **The Federal Reserve proposal and implementation of Basel III endgame reforms will come at a time when the SEC is engaged in an unprecedent rulemaking agenda that effects every asset class and will reshape our capital markets. While we do not yet have the details, the Basel revisions are likely to have a substantial impact on the capital requirements associated with markets activities. Is the Federal Reserve considering its own changes to capital requirements in coordination or consideration with the SEC's reform proposals?**

We are giving careful consideration to the broader implications of implementing the Basel III reforms, including, among other factors, accounting for the entirety of the regulatory capital framework and the broader economic context in which it operates.

2. **During times of economic uncertainty, end-users employ derivatives to manage risk. As the Federal Reserve considers changes to capital requirements, what steps are being taken to ensure that end-users are not economically harmed?**

As the Federal Reserve Board considers potential changes to capital requirements, such as the implementation of the Basel III capital reforms, we will consider the benefits and costs of the proposal broadly, as we seek to ensure we have a strong framework that supports the strength and resilience of our financial system through the economic cycle—today and in the future.

The revised Basel III framework is intended to produce more robust and internationally consistent capital requirements for the largest firms, building on improvements made to the capital framework following the 2007-2009 financial crisis. Strong capital helps to ensure that derivatives end-users, like other counterparties of banking organizations, can have confidence that their banking organization counterparties are well capitalized and able to perform on their derivative contracts across economic conditions.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Alex X. Mooney
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Alex X. Mooney:

1. **Are the clearing mandates of Dodd Frank in combination with the Held to Maturity accounting rules largely to blame for banks' failure to hedge? Does cash flow risk associated with mandatory margin requirements conflict with a bank's effort to reduce interest rate risk? In other words, if a bank were to fully hedge interest rate risk, would they then be exposed to substantial cash flow risk from the risk of mandatory margin requirements?**

Banking organizations customarily use derivatives to hedge their interest rate risks and pledge or receive collateral, cash or noncash, based on their derivative gain/loss positions. The margin requirements are in place to reduce counterparty credit risk and do not necessarily incur substantial cash flow risk to banks.

2. **Does Held to Maturity (HTM) accounting treatment reduce a bank's incentive to hedge against interest rate risk?**

    a. **Specifically, as HTM accounting treatment requires that banks report assets at amortized book value, it creates an appearance of price stability when in fact the fair market value of the assets may be changing substantially. Does this ability to hide price volatility reduce a bank's incentive to hedge?**

    b. **Held to Maturity (HTM) accounting treatment does not permit hedge accounting; hence, when a bank decides to apply HTM status, they are committing to forgo hedging, correct? Please provide your view on this tradeoff.**

    c. **Finally, please also comment on the risk of needing to mark to market all assets within an HTM portfolio when part of the portfolio is written down or moved to the Available for Sale category. How does this accounting "penalty" impact a bank's willingness or ability to liquidate assets when economically it would be necessary or beneficial.**

By law, reports or statements required to be filed with the federal banking agencies by all insured depository institutions must be uniform and consistent with U.S. generally accepted accounting principles (U.S. GAAP). Under U.S. GAAP, held to maturity classification is purposely restricted as it is intended for debt securities that a bank has the positive intent and ability to hold to maturity, regardless of changes in market interest rates. Hedging the interest rate risk of Held to Maturity debt securities would not qualify for fair value hedge accounting. However, banks are not precluded from entering into economic hedges. As a tradeoff, the benefit of reducing interest rate risk exposure with economic hedges usually overweighs the net income volatility from not being able to apply hedge accounting. Accounting classification and the applicability of hedge accounting do not preclude banks from practicing sound risk management to mitigate interest rate risk.

3. If banks were able to enter into non-margining interest rate swap agreements to hedge interest rate risk of bonds and mortgage-backed securities, would you expect banks would have been more willing to hedge?

Banking organizations consider several factors in hedging securities portfolios when making risk management decisions. It is unclear how such hypothetical changes in the margin requirements may have affected such considerations.

4. If accounting rules were changed to allow more flexibility regarding rules pertaining to hedge accounting, would you expect this to increase a bank's willingness to hedge?

It is unclear whether a change in accounting rules by the Financial Accounting Standards Board pertaining to hedge accounting would have an impact on banks' hedging activities, as the outcome could depend on an individual bank's facts and circumstances. Banking organizations consider several factors in hedging securities portfolios when making risk management decisions. Banks should exercise sound risk management practices regardless of whether they qualify for hedge accounting.

5. Would you agree that, in the case of banks, a Treasury bond or mortgage-backed Security whose interest rate risk is effectively hedged poses limited risk and should therefore be exempt from clearing requirements under Dodd-Frank? Please explain in detail.

Clearing mandates fall under the jurisdiction of the CFTC and SEC.

In general, derivative transactions include at least three types of risk: the risk based on the underlying reference instrument, counterparty credit risk, and operational risk. For the first type of risk, the value of a derivative contract can change over the life of the contract based on movements in the value of the reference rates, assets, indicators, or indices underlying the contract. For the second type of risk, a bank or other derivative counterparty is subject to the risk that its counterparty on a derivative contract could default on its obligations and fail to pay the amount owed under the transaction (counterparty credit risk). Also, the bank is subject to operational risk with respect to its derivatives business, which is risk of losses from inadequate or failed processes, such as from fraud, illegal conduct, or cyberattacks.

In a situation in which a bank uses a derivative to hedge the interest rate risk of a Treasury bond or mortgage-backed security, the bank is still exposed to counterparty credit risk on the derivative position. Central clearing is a method to mitigate counterparty credit risk, as the central clearing counterparty takes on counterparty credit risk between parties to a transaction.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 9, 2023

The Honorable Zach Nunn
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Zach Nunn:

1. **The U.S. Chamber of Commerce recently sent you a letter that stated that Main Street businesses rely on banks to support their growth and that research has shown that more stringent bank regulations make bank credit more expensive for borrowers.**

    a. **In an already- fragile economy where small businesses need reliable and affordable access to credit, do you believe that increasing borrowing costs is a good thing?**

    b. **Have you engaged with small business stakeholders to fully understand the impact the conclusions of your review will have on them? If you haven't, I think you should and would urge you to meet with small business owners to better understand the struggles they are facing in this current economy to access capital in a credit-tightening environment.**

On July 27, 2023, the Board, together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the agencies), issued a notice of proposed rulemaking to modify large bank capital requirements to better reflect underlying risks and increase the consistency of how banking organizations measure their risks.[1]

We recognize the importance of small businesses in the U.S. economy, and that banks are an important provider of financial services to smaller services.

First, I would note that smaller banks are a significant source of funding for small businesses and smaller banks would not be subject to this proposal. The proposal affects only the very largest banks – less than 40 of more than 4,000 banks in the system.

For the largest banks, as you noted, the proposal is projected to raise capital requirements, which may result in higher funding costs. But this is only half the story. As we indicated in the preamble to our capital proposal, historical experience—particularly our experience during the Global Financial Crisis—demonstrates the severe impact that distress or failure at individual banking organizations can have on the stability of the U.S. banking system. Fifteen years ago, the Global Financial Crisis starkly revealed the cost to society of a banking system that had insufficient capital. In the lead-up to the financial crisis, the rules didn't fully capture the risks of asset classes like subprime mortgages, securitizations, and derivatives, which led to enormous losses at banks. Banks were woefully undercapitalized for these losses. The financial crisis upended lives and did severe damage to the economy, causing the worst and longest recession since the Great Depression. It took six years for employment to recover, during which time long-term unemployment ran for long periods at a record high, and more than 10 million people fell into poverty. Six million families lost their homes to foreclosure. And these costs occurred even with an unprecedentedly large response by government.

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[1] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm.

The effective rise in capital requirements related to lending activities in the current proposal is a small portion of the estimated overall capital increase. The bulk of the rise in required capital anticipated in the proposed rule is attributed to trading and other activities besides lending—activities that have generated outsized losses at large banks and areas where our current rules have shortcomings.

For lending to small businesses, the proposal would introduce a more risk-sensitive standardized approach that would allow some loans to qualify for lower risk weights. Small business lending tends to entail limited individual exposures spread across a diversified set of borrowers or to be secured by real estate. Our impact analysis indicates that small business loans meeting either of these criteria would generally have flat or slightly lower capital requirements, inclusive of the operational risk requirement. Loans not meeting these criteria, generally meaning a particularly large loan to a small business, would continue to be classified as a corporate exposure. Such loans would see a small increase in required capital. Therefore, we do not expect negative impacts on lending to small businesses.

Over the last several months, I have engaged with a wide range of parties: policymakers and staff from the Federal Reserve and other agencies, banks and financial sector groups, public interest groups, members of Congress, and academics to get a broad perspective on how the Federal Reserve's capital standards interact with each other and the result they together achieve. And with the issuance of the agencies' proposal, I look forward to the public comment process.

To further refine estimates of the potential impact, the Board will collect additional data from the banks affected by the proposal.[2] This additional data will further clarify the estimated effects of the proposal and inform any final rule, with summaries to be made public. The agencies have also extended the comment period on the proposal to January 16, 2024, in order to allow interested parties more time to analyze the issues and prepare their comments.[3]

Finally, it is important to note that the proposal contemplates an effective date of July 1, 2025, for the proposed changes, with an extended transition period—so the changes will not be effective for some time. The Board implements regulatory changes through a notice-and-comment process, and generally allows for phase-in periods that allow for a gradual introduction of the new rules.

This phase-in will allow ample time for banks to adjust their balance sheets and activities, and to build capital over time. In fact, most banks already have enough capital today to meet the proposed requirements. For the banks that would need to build capital to meet the proposed requirements, assuming that they continue to earn money at the same rate as in recent years, we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their dividends.

2. I am concerned that the more capital that you push to the sidelines, the more likely you are to deprive small business owners and those borrowers at the lowest end of the credit quality spectrum ability to access reliable and affordable credit. The more capital

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[2] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020b.htm.
[3] *See* https://www.federalreserve.gov/newsevents/pressreleases/bcreg20231020a.htm.

banks are required to hold, the tighter the credit market becomes, pushing out those borrowers at the margins from securing loans at all. Are you concerned about the ripple effect of the potential new regulations on those the lowest at the lowest end of the credit quality spectrum, given the tightening that we're seeing in the market?

Robust capital is fundamental to the strength and stability of our financial system. Strong banks are best able to support households and business through the economic cycle. While I am mindful that changes in capital requirements may cause firms to change their behavior and the way that financial services are provided to our economy, I believe that the benefits of making the financial system more resilient to stresses are greater.

The Federal Reserve Board (Board) carefully considers the costs and benefits of our rulemakings, and the proposal included robust economic analysis of its impacts.

The agencies' proposal will go through the normal notice and public comment process, which includes an explanation of the proposed changes and potential impacts, as well as opportunity for comment.

3. **How are you accounting for the decreased economic output from tighter credit and the knock-on effects of decreased lending to small businesses in your holistic capital review?**

Please see my response to question 1.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 2, 2023

The Honorable Bryan Steil
House of Representatives
Washington, D.C. 20515

Dear Congressman:

Enclosed are my responses to the questions you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Questions for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Representative Bryan Steil:

1. **The last time you were here, I asked about lending by the Fed at its discount window to the FDIC posted in the Fed's H.4.1 weekly releases on factors affecting reserve balances.**

   You told me that a jump in an item called "other credit extensions" under loans the Fed was making from zero to up to nearly $180 billion was lending by the Fed to FDIC bridge banks.

   Mr. Barr, you told me it was put in the special other credit extensions line "for purposes of enhancing transparency to the public."

   Mr. Gruenberg, you told me that there may have been discussions between the FDIC and Treasury about FDIC not tapping its line of credit at Treasury because of debt limit implications, and instead going to the Fed's discount window.

   Recently, in the Fed's H.4.1 report released on May 4, there is a special explanatory paragraph identifying that the "other credit extensions" entry now includes lending to First Republic Bank at the discount window and through the Bank Term Funding Program-or BTFP.

   So, discount window lending and BTFP are being mixed.

   And the H.4.1 for May 4 says that the outstanding loans for First Republic "are being repaid from assets left behind in the receivership, proceeds of the purchase and assumption agreement between the FDIC and JPMorgan Chase Bank, National Association, and pursuant to an FDIC guarantee."

   If transparency to the public was the goal in the Fed's accounting, I don't think that goal has been met.

   Are all the discount window loans made to the FDIC fully collateralized and how can we verify that?

The Federal Reserve did not make any loans to the FDIC. In 2023, the Federal Reserve extended loans under its ordinary discount window lending authority (section 10B of the Federal Reserve Act), as well as, in one instance, under its emergency lending authority through the Bank Term Funding Program (BTFP) (established under section 13(3) of the Federal Reserve Act), to depository institutions that were later placed into FDIC receivership. Discount window loans were extended to Silicon Valley Bank, Signature Bank, and First Republic Bank, and BTFP loans were extended to First Republic Bank, in each case, before the depository institutions were placed into receivership.

Upon these institutions being placed into receivership, the discount window and BTFP loans were not assumed by the acquiring depository institutions. In each case, the outstanding discount window and BTFP loans are being repaid from the proceeds of the sales to the acquiring depository institutions, if any, and the recovery on the collateral that was left behind in the receivership, supported by the FDIC guarantees of repayment.

2. Is any of the collateral for the Fed loans held by JPMorgan Chase Bank?

Upon First Republic being placed into receivership, its outstanding discount window loans and BTFP loans were not assumed by the acquiring depository institution JPMorgan Chase Bank, and any collateral securing the outstanding borrowings of First Republic Bank after it was placed into receivership remained in the receivership.

3. What is the FDIC guarantee that the Fed has accepted as a basis for assuring repayment of any loans?

The FDIC guaranteed repayment of the outstanding discount window loans and BTFP borrowings of Silicon Valley Bridge Bank, N.A., Signature Bridge Bank, N.A., and First Republic in connection with those institutions being placed into FDIC receivership. The Federal Reserve expects that these loans will be repaid in full before the end of 2023.

4. Are any of the Fed loans being made to the FDIC instead of FDIC draws on its line of credit at Treasury because of implications for the debt limit?

The Federal Reserve extended loans under its ordinary discount window lending authority (section 10B of the Federal Reserve Act), as well as, in one instance, under its emergency lending authority through the BTFP (established under section 13(3) of the Federal Reserve Act), to depository institutions that were later placed into FDIC receivership. Upon these institutions being placed into receivership, the discount window and BTFP loans were not assumed by the acquiring depository institutions. In each case, the outstanding discount window and BTFP loans are being repaid from the proceeds of the sales to the acquiring depository institutions, if any, and the recovery on the collateral that was left behind in the receivership, supported by the FDIC guarantees of repayment.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

MICHAEL S. BARR
VICE CHAIR FOR SUPERVISION

November 2, 2023

The Honorable Maxine Waters
Ranking Member
Committee on Financial Services
House of Representatives
Washington, D.C. 20515

Dear Ranking Member Waters:

Enclosed is my response to the question you submitted following the May 16, 2023,[1] hearing before the Committee on Financial Services. A copy also has been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I may be of further assistance.

Sincerely,

Enclosure

[1] Questions for the record related to this hearing were received on June 14, 2023.

Question for The Honorable Michael S. Barr, Vice Chair for Supervision, the Federal Reserve, from Ranking Member Maxine Waters:

1. **On Thursday, May 18, 2023, the Subcommittee on Digital Assets, Financial Technology, and Inclusion held a hearing entitled "Putting the 'Stable' in 'Stablecoins:' How Legislation Will Help Stablecoins Achieve Their Promise." Two bills were posted for consideration at this hearing-one from Chairman McHenry and one from Ranking Member Waters. What is your feedback on these bills? Please include important differences between the two.**

    a. **Specifically, what are your views on how the bills outline the role of the Federal Reserve in relation to State qualified payment stablecoin issuers?**

    b. **For example, the bill from Ranking Member Waters includes a provision that allows for the Board to decline the registration of a State qualified payment stablecoin issuer prior to the issuer issuing a stablecoin, while the bill from Chairman McHenry does not. What are your views on this difference?**

I remain deeply concerned about stablecoin issuance without strong federal oversight, and I appreciate the work you have been doing on this important issue. Payment stablecoins are a form of private money, subject to the same run risk as all such forms of money. These runs could not only pose risks to consumers, but also to the broader financial system. Any instrument that is claimed to represent the U.S. dollar must be well-regulated to protect U.S. households and businesses.

We think that the central bank is and will always be the main source of trust behind all money. Stablecoins essentially borrow that trust. As a result, it is critical that the Federal Reserve play a role in ensuring stablecoins are regulated in a manner that ensures their stability.

Any legislative framework should fully address the risks associated with stablecoins, including run risks, payment system risks, and risks related to concentration of economic power that result from mixing banking and commerce and needs to:

- provide a robust federal prudential oversight framework for all stablecoin issuers, including nonbank issuers, that includes federal approval, regulation, supervision, and enforcement;
- include a robust approval process that ensures an approved stablecoin issuer can issue these monetary instruments in a safe and sound manner;
- have an appropriate regulatory perimeter to make sure that the legislation is effective and to prevent evasion;
- preserve the separation between stablecoin issuers and commercial entities; and
- regulate strictly transactions between stablecoin issuers and their affiliates.

We appreciate that states would like to have a role in the oversight of stablecoin issuance. However, the role of the states must be coupled with strong federal oversight, similar to the way federally regulated state-chartered banks are overseen.

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

August 23, 2023

The Honorable Patrick McHenry
Chairman
Committee on Financial Services
United States House of Representatives
Washington, D.C. 20515

Dear Chairman McHenry:

Please find enclosed my responses to the Questions for the Record from various members of the Committee in connection with the hearing entitled "Oversight of Prudential Regulators" on May 16, 2023.

If you have any questions regarding these responses, please contact me or Andy Jiminez, Director, Office of Legislative Affairs, at (202) 898-6761.

Sincerely,

Martin J. Gruenberg

Martin J. Gruenberg

Questions for the Record from Representative Alex X. Mooney for
The Honorable Martin J. Gruenberg
Chairman, Federal Deposit Insurance Corporation
May 16, 2023 Hearing entitled, "Oversight of Prudential Regulators
House Committee on Financial Services

1. **Are the clearing mandates of Dodd Frank in combination with the Held to Maturity accounting rules largely to blame for banks' failure to hedge?**

   Does cash flow risk associated with mandatory margin requirements conflict with a bank's effort to reduce interest rate risk? In other words, if a bank were to fully hedge interest rate risk, would they then be exposed to substantial cash flow risk from the risk of mandatory margin requirements?

   Response: Title VII of the Dodd-Frank Act creates a framework for the regulation of swap markets. Title VII grants the Commodity Futures Trading Commission (CFTC) regulatory authority over swaps, except for security-based swaps, which are regulated by the Securities and Exchange Commission (SEC). If the CFTC or the SEC determines that a swap or a security based swap should be cleared, then those swaps and security based swaps must be cleared by clearinghouses.[1] On July 10, 2012, the CFTC adopted rules implementing an end-user exception from the clearing requirement. The FDIC does not have authority to promulgate clearing requirements.

   Accounting standards do not restrict an institution from engaging in hedges, rather hedging is part of a broader risk management strategy. Furthermore, accounting standards do not restrict the ability of a banking organization to prudently manage its securities portfolio and any associated risk factors.

   Mandatory margin requirements are not an impediment to prudently managing and mitigating interest rate risk. Institutions are expected to manage interest rate risk commensurate with their risk profile and established risk tolerance levels. There are a number of methods that institutions may use to manage and control interest rate risk, including balance sheet alteration and hedging through the use derivatives. Using derivative instruments to mitigate interest rate risk exposures may be appropriate for institutions with knowledge and expertise in these instruments. Institutions should not undertake this activity unless the board and senior management understand the institution's hedging strategy when using these instruments, including the potential risks and benefits of the strategy. Hedging strategies should be appropriate for the size, complexity, and risk profile of the institution.

2. **Does Held to Maturity (HTM) accounting treatment reduce a bank's incentive to hedge against interest rate risk?**

   Specifically, as HTM accounting treatment requires that banks report assets at amortized book value, it creates an appearance of price stability when in fact the fair market value of the assets may be changing substantially. Does this ability to hide price volatility reduce a bank's incentive to hedge?

[1] *See* 7 U.S.C. § 2(h); *see also* 7 U.S.C. 78c-3(a)(1).

Questions for the Record from Representative Alex X. Mooney for
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Held to Maturity (HTM) accounting treatment does not permit hedge accounting; hence, when a bank decides to apply HTM status, they are committing to forgo hedging, correct? Please provide your view on this tradeoff.

Finally, please also comment on the risk of needing to mark to market all assets within an HTM portfolio when part of the portfolio is written down or moved to the Available for Sale category. How does this accounting "penalty" impact a bank's willingness or ability to liquidate assets when economically it would be necessary or beneficial.

Response: Institutions manage interest rate risk exposure and mitigate outsized exposures through a variety of methods, including balance sheet management and hedging activities. Institutions are expected to, and have, an economic incentive to appropriately manage interest rate risk. An institution may still engage in derivatives (or other hedging strategies) even if those strategies do not result in beneficial accounting treatment. Accounting standards do not preclude management from engaging in prudent interest rate risk management.

For HTM debt securities, a hedging strategy through the use of derivatives would not be offset on financial statements, because such securities are reported at amortized cost, and derivatives are reported at fair value in accordance with U.S. generally accepted accounting principles (i.e., ASC Topic 320, Investments–Debt Securities and ASC Topic 815, Derivatives and Hedging, respectively). However, both the amortized cost and fair value of HTM debt securities are publicly available through financial statement footnotes and Schedule RC-B in the Consolidated Reports of Condition.

If an institution sold a HTM investment that did not meet one of the "safe harbor" provisions established in ASC 320, it would "taint" the HTM portfolio, meaning the institution could not use the HTM classification for a certain period. The institution would be required to reclassify the remainder of the HTM portfolio to available-for-sale (AFS), which is held at fair value. The potential implications of these accounting standards related to HTM securities do not preclude an institution from selling an HTM security when it is economically beneficial or necessary.

3. **If banks were able to enter into non-margining interest rate swap agreements to hedge interest rate risk of bonds and mortgage-backed securities, would you expect banks would have been more willing to hedge?**

Response: Institutions manage interest rate risk exposure and mitigate outsized exposures through a variety of methods, including balance sheet management and hedging activities. Regardless of margin and clearing requirements, institutions have an economic incentive to mitigate interest rate risk through hedging and other means.

4. **If accounting rules were changed to allow more flexibility regarding rules pertaining to hedge accounting, would you expect this to increase a bank's willingness to hedge?**

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Response: Institutions manage interest rate risk exposure and mitigate outsized exposures through a variety of methods, including balance sheet management and hedging activities. Institutions are expected to and have an economic incentive to manage interest rate risk.

While accounting standards guide how transactions are reported in financial statements, they should not drive prudent risk management decisions made by institutions. Management is not prohibited from economically hedging exposures with instruments it is permitted to hold. Furthermore, financial statement footnote disclosures provide an opportunity for institutions to explain hedging strategies.

5. **Would you agree that, in the case of banks, a Treasury bond or mortgage-backed Security whose interest rate risk is effectively hedged poses limited risk and should therefore be exempt from clearing requirements under Dodd-Frank? Please explain in detail.**

Response: Title VII of the Dodd-Frank Act creates a framework for the regulation of swap markets. Title VII grants the CFTC regulatory authority over swaps, except for security-based swaps, which are regulated by the SEC. If the CFTC or the SEC determines that a swap or a security based swap should be cleared, then those swaps and security-based swaps must be cleared by clearinghouses.[2] On July 10, 2012, the CFTC adopted rules implementing an end-user exception from the clearing requirement. The FDIC does not have authority to promulgate clearing requirements.

[2] *See* 7 U.S.C. § 2(h); *see also* 7 U.S.C. 78c-3(a)(1).

Questions for the Record from Representative French Hill for
The Honorable Martin J. Gruenberg
Chairman, Federal Deposit Insurance Corporation
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"Source of Strength" Contracts

1. **Director Gruenberg, the FDIC reportedly did not execute a signed commitment from SVB Financial Group to contribute its assets to the support of its regulated subsidiary, SVB. My understanding is that the FDIC has the authority to enforce the source-of-strength doctrine between bank holding companies and their subsidiaries on a bank-by-bank basis.**

    a. **Did the FDIC have a written agreement with the holding company of Silicon Valley Bank? Please respond yes or no.**

Response: No. The FDIC was not the appropriate Federal banking agency (AFBA) for SVB Financial Group for the purposes of the source-of-strength provisions of section 38A of the Federal Deposit Insurance Act (FDI Act). The Federal Reserve was the primary federal regulator for both the holding company as well as the insured depository institution, SVB.

    b. **If yes, why did the FDIC choose to not execute such a signed commitment between SVB and its parent holding company?**

Response: For the purposes of section 38A of the Federal Deposit Insurance Act, the FDIC was not the AFBA for SVB's bank holding company, SVB Financial Group, and therefore did not impose a requirement for SVB Financial Group to serve as a source of financial strength for its subsidiary depository institution, SVB.

    c. **Does the FDIC and the Federal Reserve have a written supervisory agreement with holding companies of banks that have over 50% of their deposits in uninsured accounts? Please respond yes or no.**

Response: No.

    d. **How do you think about the source-of-strength doctrine? Does it represent enforceable financial lability or is it aspirational for an institution's resolution plan?**

Response: Under section 38A of the FDI Act the AFBA for a bank holding company or savings and loan holding company shall require the bank holding company or savings and loan holding company to serve as a source of financial strength for any depository institution subsidiary of the bank holding company or savings and loan holding company. The FDIC is not the AFBA for bank holding companies or savings and loan holding companies; therefore, it was not the AFBA for either SVB or SVB Financial Group.

Section 38A also states that, with respect to an insured depository institution that is the subsidiary of a company that is not a bank holding company or savings and loan holding

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company, the AFBA for the insured depository institution shall require that parent company to serve as a source of financial strength for the subsidiary insured depository institution. Historically, the FDIC typically required capital and liquidity maintenance agreements under which such companies pledge to strengthen subsidiary institutions in the event of financial stress. The FDIC's final rule under Part 354, issued in February 2021, explicitly requires such companies to enter into written agreements with the FDIC to maintain the capital and liquidity of the subsidiary at such levels as the FDIC deems appropriate, and to take such other actions as the FDIC deems appropriate to provide the subsidiary with a resource for additional capital and liquidity, and providing indemnification of the subsidiary.[3] Such written agreements are, by their terms and by law, enforceable under sections 8 and 50 of the FDI Act, 12 U.S.C. §§ 1818, 1831aa.

Parent resources as a source of strength would generally be expected to be used to support a firm during recovery from financial stress prior to and with the intent of avoiding failure of the bank subsidiary. These arrangements are generally not anticipated to be available as a resource in resolution planning, but may provide a claim by the receiver of the failed bank in the event that the required support was not provided prior to resolution. A more rigorous source of strength requirement that applied to all bank holding companies through a regulation subject to notice and comment as contemplated in the Dodd Frank Act, rather than through reliance on individual agreements, could improve the prospects for recovery of a troubled bank, would reduce costs in resolution, and likely reduce ambiguity for a range of stakeholders (supervisors, resolution authorities, holding companies and creditors).

[3] *See* 12 CFR 354.4 (a)(7).

Questions for the Record from Representative Bryan Steil for
The Honorable Martin J. Gruenberg
Chairman, Federal Deposit Insurance Corporation
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For Chairman Gruenberg and Vice Chairman Barr

The last time you were here, I asked about lending by the Fed at its discount window to the FDIC posted in the Fed's H.4.1 weekly releases on factors affecting reserve balances.

You told me that a jump in an item called "other credit extensions" under loans the Fed was making from zero to up to nearly $180 billion was lending by the Fed to FDIC bridge banks.

Mr. Barr, you told me it was put in the special other credit extensions line "for purposes of enhancing transparency to the public."

Mr. Gruenberg, you told me that there may have been discussions between the FDIC and Treasury about FDIC not tapping its line of credit at Treasury because of debt limit implications, and instead going to the Fed's discount window.

Recently, in the Fed's H.4.1 report released on May 4, there is a special explanatory paragraph identifying that the "other credit extensions" entry now includes lending to First Republic Bank at the discount window and through the Bank Term Funding Program-or BTFP.

So, discount window lending and BTFP are being mixed.

And the H.4.1 for May 4 says that the outstanding loans for First Republic "are being repaid from assets left behind in the receivership, proceeds of the purchase and assumption agreement between the FDIC and JPMorgan Chase Bank, National Association, and pursuant to an FDIC guarantee."

If transparency to the public was the goal in the Fed's accounting, I don't think that goal has been met.

1. **Are all the discount window loans made to the FDIC fully collateralized and how can we verify that?**

Response: The Federal Reserve Banks did not provide any loans to the FDIC. Prior to the bank failures of Silicon Valley Bank (SVB), Signature Bank, and First Republic Bank, the Federal Reserve's discount window loans were available to these three banks in the usual course of business. In addition, Bank Term Funding Program (BTFP) loans were provided to First Republic Bank upon its request under the terms of that program. Once SVB and Signature Bank failed, two new, Office of the Comptroller of the Currency (OCC)-chartered bridge banks were created and the Federal Reserve Banks provided discount window loans to each of these open and operating institutions. Upon the sale of these three institutions, the Federal Reserve

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borrowings were retained by the receiverships—they were not assumed by the acquiring institutions. Those outstanding borrowings will be repaid from the proceeds of the sales to the acquiring institutions, if any, and the recoveries on collateral that was left behind in each receivership. All of these borrowings that now reside in the respective receiverships are supported by an FDIC guarantee of full repayment.

2. Is any of the collateral for the Fed loans held by JPMorgan Chase Bank?

Response: No, there is no collateral being held by JPMorgan Chase. JPMorgan Chase acquired First Republic Bank through a whole bank resolution transaction. In exchange, the FDIC retained some assets, received a $10.6 billion cash payment, and received a $50 billion purchase money note. The Fed loans, which are currently covered by an FDIC guarantee rather than collateral, have been paid down from the proceeds of the sale of First Republic and from the assets retained. The remaining loan balance will be repaid through monetization of the $50 billion purchase money note and, if necessary, from a payment from the Deposit Insurance Fund.

3. What is the FDIC guarantee that the Fed has accepted as a basis for assuring repayment of any loans?

Response: The FDIC, as manager of the Deposit Insurance Fund, has provided a Corporate guarantee that is backed by the full faith and credit of the US government.

4. Are any of the Fed loans being made to the FDIC instead of FDIC draws on its line of credit at Treasury because of implications for the debt limit?

Response: No. As open and operating OCC-chartered national banks, the bridge banks borrowed from the Federal Reserve's discount window in the usual course of business. Additionally, First Republic Bank borrowed from the discount window prior to its resolution.

Questions for the Record from Representative Andrew Garbarino for
The Honorable Martin J. Gruenberg
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1. **Dodd Frank included a number of important provisions designed to ensure that the methodology used to assess deposit insurance is appropriately tied to risk. Why does the proposed special assessment disregard the risk-based assessment methodology that is enshrined in the Dodd-Frank Act and applied to regular assessments?**

Response: The proposed special assessment was issued pursuant to the FDIC's authority under section 13(c)(4)(G) of the Federal Deposit Insurance Act (FDI Act).[4] Regular assessments are imposed pursuant to the FDIC's authority in section 7(b)(1) of the FDI Act,[5] which requires that the FDIC establish a risk-based assessment system. These are distinct authorities with different purposes and requirements.

The special assessment authority requires that the loss to the Deposit Insurance Fund (DIF) arising from the use of a systemic risk exception must be recovered from one or more special assessments on insured depository institutions (IDIs), depository institution holding companies (with the concurrence of the Secretary of the Treasury with respect to holding companies), or both, as the FDIC determines to be appropriate. The proposed special assessment is intended and designed to recover the losses to the DIF incurred as the result of the actions taken by the FDIC to protect the uninsured depositors of Silicon Valley Bank and Signature Bank following the determination of systemic risk announced on March 12, 2023.

Section 13(c)(4)(G) of the FDI Act provides the FDIC with discretion in the design and time frame for any special assessments to recover the losses to the DIF as a result of the systemic risk determination. In implementing special assessments under section 13(c)(4)(G) of the FDI Act, the FDIC is required to consider the types of entities that benefit from any action taken or assistance provided under the determination of systemic risk, economic conditions, the effects on the industry, and such other factors as the FDIC deemed appropriate and relevant to the action taken or assistance provided. In general, large banks with large amounts of uninsured deposits benefited the most from the systemic risk determination.

Under the proposal for the special assessment, the FDIC would impose a special assessment rate equal to approximately 12.5 basis points annually. The special assessment rate was derived by dividing the current loss estimate attributable to the protection of uninsured depositors of $15.8 billion by the proposed assessment base calculated for all IDIs subject to the special assessment. The resulting rate is then divided by two to reflect the two year (eight-quarter) collection period, resulting in an annual rate of approximately 12.5 basis points.

The FDIC requested comment on all aspects of the proposed rule to implement the special assessment, and asked multiple questions about the assessment base for the special assessment. Specifically, Question 1 asks: "Should the special assessments be calculated as proposed?"

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[4] *See* 12 U.S.C. 1823(c)(4)(G).
[5] *See* 12 U.S.C. 1817(b)(1).

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The proposed rule to implement the special assessment was published in the *Federal Register* on May 22, 2023 and was open for a 60-day comment period, closing July 21, 2023. The FDIC encouraged comment from all interested parties. The FDIC will consider all comments carefully before finalizing the rule.

2. **All uninsured deposits are not equal. Many banks maintain large uninsured deposits balances for clients' operational purposes, which the FDIC, FRB, and OCC recognize as inherently more stable than other types of uninsured deposits in prudential liquidity requirements (e.g. lower LCR outflow rates for operational deposits). Further, many banks deposit large amounts of cash at central banks, and generally adhere to sound balance sheet management principles (e.g. limiting duration and asset-liability maturity mismatch). How does this non-risk-based methodology impact essential, stable, cash intensive activities?**

Response: The proposed rule would apply an annual special assessment rate of approximately 12.5 basis points to an assessment base that would equal an IDI's estimated uninsured deposits reported as of December 31, 2022. For IDIs that are not part of a holding company, the first $5 billion in estimated uninsured deposits would be excluded from the assessment base. For IDIs that are part of a holding company, the first $5 billion of the combined banking organization's estimated uninsured deposits would be excluded.

Deposits are the most common funding source for many IDIs; however, other liability sources such as borrowings can also provide funding. Deposits and other liability sources are often differentiated by their stability and customer profile characteristics. While some uninsured deposit relationships remain stable when a bank is in good condition, such relationships might become less stable due to their uninsured status if a bank experiences financial problems or if the banking industry experiences stress events.

The FDIC requested comment on all aspects of the proposed rule to implement the special assessment, and asked multiple questions about the assessment base for the special assessment. Specifically, Question 7 asks: "Should the FDIC consider an exemption for specific types of deposits from the base for special assessments? On what basis?"

The proposed rule was published to the *Federal Register* on May 22, 2023 and was open for a 60-day comment period, closing July 21, 2023. The FDIC encouraged comment from all interested parties. The FDIC will consider all comments carefully before finalizing the rule.

3. **Did the FDIC use risk-based assessment following the financial crisis for the 2009 special assessment? If so, why does the FDIC use a non-risk based assessment base (uninsured deposits) for this proposed special assessment which does not capture the stability and different types of uninsured deposits or sound asset liability management?**

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Response: No, the FDIC did not use risk-based pricing for the 2009 special assessment. The 2009 special assessment was imposed on IDIs pursuant to section 7(b)(5) of the FDI Act, governing emergency special assessments. In 2009, the FDIC imposed a 5 basis point special assessment on each IDI's assets minus Tier 1 capital (as of June 30, 2009).

Section 7(b)(5) of the FDI Act allows the FDIC to impose one or more special assessments on IDIs in an amount determined by the FDIC for any purpose that the FDIC may deem necessary. One of the FDIC's principal purposes in imposing a special assessment in 2009 was to prevent the reserve ratio of the DIF from declining to zero or below.

The special assessment proposed in May 2023 was pursuant to section 13(c)(4)(G) of the FDI Act, which requires the loss to the DIF arising from the use of a systemic risk exception to be recovered from one or more special assessments. Section 13(c)(4)(G) provides the FDIC with discretion in the design and time frame for any special assessments to recover the losses to the DIF as a result of the systemic risk determination. In implementing special assessments under section 13(c)(4)(G) of the FDI Act, the FDIC is required to consider the types of entities that benefit from any action taken or assistance provided under the determination of systemic risk, economic conditions, the effects on the industry, and such other factors as the FDIC deemed appropriate and relevant to the action taken or assistance provided. The proposed assessment base reflected the FDIC's consideration of these factors.

The FDIC requested comment on all aspects of the proposed rule to implement the special assessment, and asked multiple questions about the assessment base for the special assessment. Specifically, Question 4 asks: "Should the assessment base for the special assessments be equal to estimated uninsured deposits or some other measure?"

The proposed rule was published in the *Federal Register* on May 22, 2023 and was open for a 60-day comment period, closing July 21, 2023. The FDIC encouraged comment from all interested parties. The FDIC will consider all comments carefully before finalizing the rule.

4. **In your testimony you noted the Dodd-Frank statute gives the FDIC authority to target the special assessment on the institutions that benefited from the systemic risk action, and as a result the FDIC decided to link benefit of systemic risk exemption to institutions who benefitted with it is to track it with the amount of uninsured deposits. Please explain how the largest banks benefited from the systemic risk exception. Please list which institutions benefited and how they specifically benefited from your use of the systemic risk exemption? Please confirm if SVB and Signature were the only two institutions that benefited, and if there were others institutions that benefited please explain how?**

Response: In general, large banks and regional banks, and particularly those with large amounts of uninsured deposits, were the banks most exposed to and likely would have been the most affected by uninsured deposit runs. Indeed, shortly after Silicon Valley Bank (SVB) was closed,

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a number of IDIs with large amounts of uninsured deposits reported that depositors had begun to withdraw their funds. The failure of SVB and the impending failure of Signature Bank raised concerns that, absent immediate assistance for uninsured depositors, there could be negative knock-on consequences for similarly situated IDIs, depositors and the financial system more broadly. Generally speaking, larger banks benefited the most from the stability provided to the banking industry under the systemic risk determination

With the rapid collapse of SVB and Signature Bank in the span of 48 hours, concerns arose that risk of runs by uninsured depositors could spread more widely to other IDIs and that the financial system as a whole could be placed at risk. The extent to which IDIs rely on uninsured deposits for funding varies significantly. Uninsured deposits were used to fund nearly three-quarters of the assets at SVB and Signature Bank.

On average, the largest banking organizations by asset size fund a larger share of assets with uninsured deposits, as depicted in Table 1 below, based on data as of December 31, 2022. Among banking organizations that report uninsured deposits, those with total assets between $1 billion and $5 billion are generally the least reliant on uninsured deposits for funding, with uninsured deposits averaging 28.1 percent of assets, compared with the largest banking organizations with total assets greater than $250 billion, which had uninsured deposits that averaged 35.8 percent of assets.

Table 1 – Average Share of Assets Funded by Uninsured Deposits, By Banking Organization Asset Size
[Percent]

Asset Size of Banking Organization	**Average Share of Assets Funded by Uninsured Deposits** [Percent]
$1 to $5 Billion	28.1
$5 to $10 Billion	28.9
$10 to $50 Billion	32.1
$50 to $250 Billion	34.2
Greater than $250 Billion	35.8

Based on Federal Reserve data reported by a sample of domestically chartered banks, domestic deposits declined by over 2 percent during the first two months of 2023, predominately among the top 25 commercial banks by asset size. This followed similar declines in domestic deposits over the prior three quarters, likely driven by the shift of certain types of deposits into higher-yielding alternatives. Following the March 2023 bank failures and the determination of systemic risk, deposits of the top 25 commercial banks grew slightly while some other banks' deposit outflows rapidly accelerated, with banks outside of the top 25 experiencing a four percent decline in two weeks. Since late March, Federal Reserve data indicates that deposit

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flows have stabilized, with some reversal of prior outflows.[6] First quarter earnings releases of select regional banks confirmed sizeable outflows of deposits, while other large and regional banks reported more modest declines or inflows.

Following the announcement of the systemic risk determination, the FDIC observed a significant slowdown in uninsured deposits leaving certain institutions, evidence that the systemic risk determination helped stem the outflow of these deposits while providing stability to the banking industry.

Under the proposal, the banks that benefited most from the assistance provided under the systemic risk determination would be charged special assessments to recover losses to the DIF resulting from the protection of uninsured depositors, with banks of larger asset sizes and that hold greater amounts of uninsured deposits paying higher special assessments.

Based on data reported as of December 31, 2022, the FDIC estimates that 113 banking organizations, which include IDIs that are not subsidiaries of a holding company and holding companies with one or more subsidiary IDIs and which comprise 83 percent of industry assets, would be subject to special assessments, including 48 banking organizations with total assets over $50 billion and 65 banking organizations with total assets between $5 and $50 billion. No banking organizations with total assets under $5 billion would pay special assessments, based on data as of December 31, 2022. The number of banking organizations subject to special assessments may change prior to any final rule depending on any adjustments to the loss estimate, mergers or failures, or amendments to reported estimates of uninsured deposits.

[6] *See* Board of Governors of the Federal Reserve System, "Assets and Liabilities of Commercial Banks in the United States—H.8," available at https://www.federalreserve.gov/releases/h8/default.htm

Questions for the Record from Representative Mike Lawler for
The Honorable Martin J. Gruenberg
Chairman, Federal Deposit Insurance Corporation
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1. **Chairman Gruenberg, in the FDIC's report on the collapse of Signature Bank, reputation risk associated with the bank's involvement with digital assets was highlighted as a factor in the bank's collapse. Given that the FDIC together with the Board and the OCC issued a statement claiming that digital assets are "highly likely to be inconsistent with safe and sound banking practices," is it fair to say that the FDIC also contributed to the reputation risk that it claims played a role in the collapse of Signature Bank?**

Response: The Joint Statement on Crypto-Asset Risks to Banking Organizations[7], issued by the FDIC, Office of the Comptroller of the Currency, and Board of Governors of the Federal Reserve System on January 3, 2023 was issued to remind banking organizations of a number of risks associated with crypto-assets that were highlighted by the events of the past year and to promote strong risk management and compliance with applicable laws and regulations. Among other risks, the statement outlined specific risks related to open, public, and/or decentralized networks, or similar systems, such as:

- the lack of governance mechanisms establishing oversight of the system;
- the absence of contracts or standards to clearly establish roles, responsibilities, and liabilities; and
- vulnerabilities related to cyber-attacks, outages, lost or trapped assets, and illicit finance.

The statement did not state or take the position that crypto-assets are highly likely to be inconsistent with safe and sound banking practices. Rather, the statement more narrowly stated, that, "Based on the agencies' current understanding and experience to date, the agencies believe that issuing or holding as principal crypto-assets that are issued, stored, or transferred on an open, public, and/or decentralized network, or similar system is highly likely to be inconsistent with safe and sound banking practices." This is reflective of the risks outlined in the statement related to open, public, and/or decentralized networks or similar networks. The FDIC is reviewing all activities on a case-by-case basis to understand the risks associated with specific crypto-related activities and to provide supervisory feedback to those banks. Signature Bank was not issuing or holding as principal crypto-assets that were issued, stored, or transferred on an open, public, and/or decentralized network or similar system.

   a. **According to Adrienne Harris, Superintendent of the New York Department of Financial Services, it is a "misnomer" to claim that digital assets played a role in the collapse of Signature Bank. Would you shed some light on the position of the FDIC and the rationale behind its statement?**

Response

[7] FDIC, "Joint Statement on Crypto-Asset Risks to Banking Organizations," FIL-01-2023 (Jan. 5, 2023) available at https://www.fdic.gov/news/financial-institution-letters/2023/fil23001.html.

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The Joint Statement on Crypto-Asset Risks to Banking Organizations[8] highlights risks associated with the Crypto-Asset Sector including, but not limited to the following: Risk of fraud and scams among crypto-asset sector participants, legal uncertainties, inaccurate or misleading representations and disclosures, practices that may be unfair, deceptive, or abusive, significant volatility in crypto-asset markets, contagion and individual bank concentration risk, and lack of robust and mature risk management and governance practices.

The Report of the FDIC Chief Risk Officer[9] dated April 28, 2023 identified the role of crypto-assets in the failure of Signature Bank of New York (SBNY), specifically, "SBNY's board and management employed a strategy of rapid growth and expansion into the digital asset markets. The strategy exposed SBNY to greater susceptibility to liquidity, reputation, and regulatory risk due to the uncertainty and volatility of the digital asset space. The growth fueled by its pursuit of digital marketplace players exposed SBNY to bank runs and contagion, particularly in regards to crypto-related entities such as FTX, Alameda, and Silvergate. Pursuit of this strategy also increased the volatility and susceptibility of SBNY's more traditional depositor sources to event shocks and depositor runs. Management was not sufficiently prepared to ameliorate the risks posed by its concentration of deposits and lending relationships in the digital assets marketplace and seemed unaware of the potential damage it could inflict on its more traditional depositor customers."

[8] *See* FDIC, Fed. Reserve System, OCC, "Joint Statement on Crypto-Asset Risks to Banking Organizations," (Jan. 3, 2023) available at https://www.fdic.gov/news/press-releases/2023/pr23002a.pdf
[9] *See* FDIC, "FDIC's Supervision of Signature Bank," (Apr. 28, 2023) available at https://www fdic.gov/news/press-releases/2023/pr23033a.pdf

Questions for the Record from Representative Andy Barr for
The Honorable Martin J. Gruenberg
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1. **Late last year, the Fed and the FDIC issued an advance notice of proposed rulemaking regarding resolution plans for large, non-G-SIB banks. Although these banks have grown in size, they continue to focus on commercial and retail banking.**

    a. **Would placing more stringent resolution planning and long-term debt requirements make them less competitive than their regional competitors?**

Response: In October 2022, the FDIC and Federal Reserve jointly published an Advance Notice of Proposed Rulemaking (ANPR) concerning potential new resolution-related resource requirements[10], such as a long-term debt requirement, for large banking organizations[11] to improve the prospects for the orderly resolution of large banks.

The recent bank failures demonstrate the implications that banks with assets of $100 billion or more can have for financial stability. Given the financial stability risks caused by the recent failures, the methods for planning and carrying out a resolution of banks with assets of $100 billion or more merit special attention.

A long-term debt buffer on which comment was sought in the ANPR could have improved the likelihood that an all-deposits bridge bank resolution would have met the least-cost resolution requirement, and protected uninsured depositors without use of a systemic risk exception. The ANPR solicited comments on the potential effects of a long term debt requirement on firms' funding model and funding costs and on the potential effects of a long-term debt requirement on the cost and availability of credit. These comments will inform the FDIC's consideration of a rule making on this subject.

    b. **Would you agree that the reason these banks are not regulated as G-SIBs is that they do not have the complexity and footprint that the large global banks have?**

Response: Unlike the GSIBs, most large banking organizations do not have material broker dealers or international operations, and their assets and liabilities most often are overwhelmingly concentrated in the depository institution entity. Some may have an international footprint or activities, assets, or services outside the bank chain, but have less complex operations and fewer systemically important critical operations.

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[10] *See* FDIC, Fed. Reserve System, "Resolution-Related Resource Requirements for Large Banking Organizations," ANPR. 87 FR 64,170 (Oct. 24, 2022) available at https://www.fdic.gov/news/board-matters/2022/2022-10-18-notice-dis-b-fr.pdf.

[11] The term large banking organization refers to a domestic bank holding company, or domestic savings and loan holding company, that has $100 billion or more in total consolidated assets but is not a GSIB under the Federal Reserve's capital rule, 12 CFR part 217, or a savings and loan holding company that would be identified as a GSIB under the Federal Reserve's capital rule if it were a bank holding company. The total population of large banking organizations corresponds to Category II through IV firms under the Federal Reserve's tiering framework for enhanced prudential standards.

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However, in recent years, merger activity and organic growth have increased the size of large banking organizations that are not GSIBs, including an increased volume of uninsured deposits and, in some cases, development of more complex organizations. As of December 2019, the domestic Category III firms had an average of approximately $413 billion in total consolidated assets, while as of December 2022, the same group of large banking organizations had grown to an average size of approximately $559 billion in total consolidated assets.[12] While most of these firms' overall business remains concentrated in traditional banking activities, and their proportion of total banking sector assets has remained relatively constant, their larger size heightens the potential impact of a possibly costly resolution.

2. **Mergers and acquisitions ensure that we do not have a barbell banking system with a number of small banks and a number of GSIB banks, but no healthy mid-size bank sector in the middle. Does your agency recognize the importance of mergers for the diversity and strength of the financial system? Can you commit to complying with the timelines given to you in statute to either approve or deny a merger application?**

Response: The FDIC reviews proposed merger transactions pursuant to the Bank Merger Act, as codified in Section 18(c) of the Federal Deposit Insurance Act (FDI Act). The Bank Merger Act prohibits an insured depository institution (IDI) from engaging in a merger transaction without regulatory approval. The FDIC has jurisdiction to act on merger applications that solely involve IDIs in which the acquiring, assuming, or resulting institution is FDIC-supervised. The FDIC also has jurisdiction to act on merger applications that involve an IDI and any entity not insured by the FDIC, notwithstanding the IDI's charter. In the context of reviewing a merger application under the Bank Merger Act, the FDIC must evaluate the following statutory factors regardless of the size of the merging entities:

(1) competitive effects (including whether the transaction would result in a monopoly in any section of the country, or whether it would substantially lessen competition in any section of the country or otherwise restrain trade);
(2) financial and managerial resources of the existing and proposed institutions;
(3) future prospects of the existing and proposed institutions;
(4) convenience and needs of the community to be served;
(5) risk to the stability of the United States banking or financial system; and
(6) effectiveness of the involved IDIs in combatting money laundering activities.

The FDIC's analysis of these factors promotes the safe and sound operation of resulting IDIs and, in turn, promotes a strong and vibrant banking industry. Favorable staff recommendations with regard to a proposed merger transaction are generally not made unless the application demonstrates that the resulting IDI would not adversely affect competition and would not result in unfavorable findings with respect to any of the other items noted above. In addition to evaluating whether any anti-competitive effects exist, the FDIC's assesses the risk to the stability

[12] *See* FR Y–9C Schedule HC—Consolidated Balance Sheet, for Category II and III bank holding companies.

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of the United States banking or financial system. The analysis of these factors considers a variety of quantitative and qualitative considerations including market competitiveness, the products and services offered, the size and complexity of the entities involved in the transaction, their degree of interconnectedness with the banking or financial system, the availability of substitute providers for critical products and services, and other relevant items. The diversity and strength of the banking industry is protected through this review process as well.

Neither the Bank Merger Act nor Section 18(c) of the FDI Act provide processing time frames for acting on bank merger applications. However, Section 343(a)[13] of the Riegle Community Development and Regulatory Improvement Act of 1994 (Riegle Act) requires federal banking agencies to take final action on applications before the end of the one-year period beginning the day after a substantially complete filing is received. Section 343(b) of the Riegle Act provides that the person submitting the application may grant a waiver of the time limit at any time.

The regulatory framework does allow for expedited processing in certain cases.[14] The FDIC generally acts on expedited applications by the later of: 45 days from receiving a substantially complete application; 10 days from the last publication; five days from receiving the Attorney General's competitive factors report; or for an interstate bank merger (subject to Section 44 of the FDI Act), five days after confirming the host state's filing requirements were met. Failure to act within the expedited processing timeframes does not constitute an automatic or default approval. If an application is not subject to expedited processing, the FDIC strives to act as promptly as possible following receipt of a substantially complete application.

[13] *See* 12 U.S.C. 4807.

[14] In order to qualify for expedited processing, all entities must be "eligible" IDIs as defined in Section 303.2(r) of the FDIC Rules and Regulations, and the resulting IDI must be Well Capitalized immediately following the merger. Expedited processing may also apply (under Section 303.64(a)(4)(ii) of the FDIC Rules and Regulations) if the acquiring party is an eligible IDI and the amount of the total assets to be transferred does not exceed ten percent of the acquiring IDI's total assets.

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1. **Does the FDIC take responsibility for the delay in selling SVB which may have contributed to emergence of a threat to stability of the U.S. financial system and led to a significant hit to the Deposit Insurance Fund?**

Response: The FDIC sought to resolve Silicon Valley Bank (SVB) as expeditiously as possible, and in a manner that maintained stability and public confidence by using a fair, transparent, and confidential auction process. Ordinarily, the FDIC has significantly more time to gather data and organize the process so that bidders may have significantly more time to conduct due diligence. In a typical bank resolution, the FDIC has at least 90 days[15] prior to failure to develop a marketing plan, establish and populate a virtual data room (VDR), engage with qualified parties, and approve interested bidders to begin due diligence.

Given the rapid nature of SVB's failure—the FDIC was notified by the primary federal regulator of an unprecedented run on the bank the evening of March 9 and the next day SVB was declared insolvent by California state authorities, and the FDIC was named receiver—there was no opportunity for the FDIC to prepare a VDR or offering materials, generate bidder interest, or market the institution prior to its failure.

Shortly after its appointment, the FDIC initiated an auction process and used the weekend of March 11 and 12 to engage prospective bidders, and actively solicited interest for purchase and assumption of the failed bank. The limited time and information available for bidders to conduct due diligence resulted in the FDIC receiving just three bids from two institutions. Only one of these bids was a valid[16] offer on the insured deposits and some of the assets of SVB, though that issue was not the only obstacle to a sale of the institution that initial weekend. The costs associated with both the valid and the invalid offers would have resulted in recoveries significantly below the estimated recoveries in liquidation and were therefore unacceptable because they did not meet the statutory least cost requirement.

On March 12, coinciding with the conclusion of the initial auction, a Systemic Risk Exception (SRE) was invoked for SVB. The SRE gave the FDIC legal authority to consider resolution options other than those deemed to be least costly to the Deposit Insurance Fund (DIF), but appropriate considering the objective of preserving financial stability in the banking system. The FDIC formed Silicon Valley Bridge Bank (SVBB) and transferred substantially all of SVB's deposits and assets into SVBB. Similarly, all deposits and substantially all of the assets of Signature Bank were assumed by Signature Bridge Bank (SBB). With the time provided by the bridge bank, the FDIC initiated a second auction process. Given SVB's niche business model in terms of activity and geography, the FDIC sought to balance the objectives of a rapid marketing

[15] 90 days prior to an anticipated failure date is typically at the time the bank board is given a final notification letter as part of the Prompt Corrective Action framework.
[16] The other institution failed to submit a resolution from its board of directors authorizing its offers on SVB, so its offers could not be considered.

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process, which was critical to preserve franchise value, with providing bidders sufficient time to conduct due diligence and formulate their bids.

The FDIC conducted a second auction process, which was organized and timed in a way that took into account feedback from prospective bidders, and which ultimately concluded on Friday, March 24 at 8:00 p.m. EDT. The FDIC received 31 bids from 20 bidders, including bids under the whole bank, private bank, and asset portfolio options. The bids received at this time were considerably better than those received earlier in the marketing process. The FDIC reviewed the bids and determined the bid of First-Citizens Bank & Trust Company to be the least costly. On March 26, 2023, the FDIC entered into a purchase and assumption agreement for all deposits and loans of SVBB.

National Credit Union Administration

United States House Financial Services Committee
Hearing on Oversight of Prudential Regulators
May 16, 2023

Responses to the Questions for the Record

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Rep. Kim:

1. *The NCUA recently released a Request for Information on climate-related financial risk, posing 38 questions about physical risk, transition risk, governance and other topics. Regardless of the responses you receive to this RFI, do you think it is appropriate for the agency to regulate in this area without a clear directive from Congress?*

   Response: The NCUA's regulatory actions are based on the authority granted by Congress. The NCUA's mission is to "protect the system of cooperative credit and its member-owners through effective chartering, supervision, regulation, and insurance." Consistent with these aims, the NCUA has statutory responsibility for a wide variety of regulations that protect the credit union system, members, and the Share Insurance Fund.

   Climate change is accelerating, and the number — and cost — of climate-related natural disasters is rising. The physical effects of climate change, along with associated transition costs, pose significant risks to the U.S. economy and the U.S. financial system. Economic and financial disruptions and uncertainties arising from both the physical and transition risks could affect the credit union industry across many dimensions and cause material financial risks. Climate-related physical and transition risks tend to manifest as traditional financial risks, including credit, liquidity, market, and operational risks.

   As such, the NCUA is one of several federal financial institution regulators to issue climate-related financial risk RFIs over the past two years. By issuing the RFI, the NCUA hopes to inform its understanding of climate-related financial risks, how credit unions view those risks, and how it can best support the industry in mitigating those risks. In addition, the NCUA hopes to gather information on the products and services credit unions may offer to capitalize on the opportunities presented by the transition to clean energy.

2. *The implementation and operation of the NCUA's Modern Examination and Risk Identification Tool (MERIT) has ballooned in recent years — most recently, with an 80 percent increase from the 2022 to 2023 annual budget. How is the NCUA controlling its spending on this program so as to not divert valuable dollars away from credit unions working to help their communities?*

   Response: The efficiency and effectiveness of the agency's workforce depend upon the availability of modern analytical tools and the resiliency of the NCUA's information technology systems. The NCUA is committed to implementing its new technology responsibly and delivering secure, reliable, and innovative solutions. The investments funded

in the NCUA's budget will provide the tools and technology the workforce needs to achieve the NCUA mission.

The 2023 budget includes the third year of funding for operations and maintenance of the MERIT system, which replaced the legacy AIRES examination system in 2021. The AIRES examination system had been in place for more than two decades and was run on outdated computer code. The 2023 funding for MERIT's operations included contract services for information technology infrastructure services and operations and maintenance labor support.

What's more, the NCUA has robust governance and oversight processes in place to monitor and control the costs of operating MERIT and related projects. Now that MERIT is in the operations and maintenance phase, the NCUA's cost profile for future years has flattened, with most increases being driven by support contracts and software license escalation. Further, as part of operations and maintenance activities, the NCUA routinely evaluates and optimizes service delivery to reduce costs.

MERIT is an enterprise system enabling NCUA staff and our state regulatory partners to complete our mission. Moving forward, the NCUA will continue to make modest investments in MERIT, as represented in the acquisitions line in the agency's publicly available budget narrative, to achieve the agency's strategic priorities, enable staff efficiencies, and make required system upgrades to ensure data security.

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Rep. Mooney:

1. *Are the clearing mandates of Dodd-Frank, in combination with the Held to Maturity accounting rules, largely to blame for banks' failure to hedge?*

   Response: The NCUA defers to the banking regulators on this question as credit unions generally are not subject to the clearing mandates of the Dodd-Frank Act. That said, the Dodd-Frank's mandates for centralized derivative clearing mutualized the risk of default by counterparties, thus minimizing the systemic risk of a counterparty default.

2. Does cash flow risk associated with mandatory margin requirements conflict with a bank's effort to reduce interest rate risk? In other words, if a bank were to fully hedge interest rate risk, would they then be exposed to substantial cash flow risk from the risk of mandatory margin requirements?

   Response: The NCUA defers to the banking regulators with experience in implementing this mandate.

3. *Does Held to Maturity (HTM) accounting treatment reduce a bank's incentive to hedge against interest rate risk?*

   Specifically, as HTM accounting treatment requires that banks report assets at amortized book value, it creates an appearance of price stability when the fair market value of the assets may be changing substantially. Does this ability to hide price volatility reduce a bank's incentive to hedge?

   Response: The NCUA regulates credit unions and defers to the federal banking agencies for a response on the effect of held to maturity accounting on banks. That said, a financial institution's interest rate risk management policies should consider the entire balance sheet's sensitivity to changes in interest rates and would not be disincentivized to hedge a particular asset class.

4. *Held to Maturity (HTM) accounting treatment does not permit hedge accounting; hence, when a bank decides to apply HTM status, they are committing to forgo hedging, correct? Please provide your view on this tradeoff.*

   Response: The NCUA defers to banking regulators for a response as the question is focused on banks.

5. *Finally, please also comment on the risk of needing to mark to market all assets within an HTM portfolio when part of the portfolio is written down or moved to the Available for Sale category. How does this accounting "penalty" impact a bank's willingness or ability to liquidate assets when economically it would be necessary or beneficial.*

Response: But for specific circumstances, the tainting rule requires reclassifying the entire held to maturity portfolio when a security is sold before maturity. Financial institutions may perceive this as a penalty in a rising interest rate environment and will consider the effects on financial reporting in its liquidity management.

For credit unions, when held to maturity debt securities are classified as available for sale, the change to fair value is reported in other comprehensive income. The balance sheet would reflect this as accumulated other comprehensive income in the equity section. For credit unions, accumulated other comprehensive income is excluded from regulatory capital and the net worth ratio for prompt corrective action.

6. *If banks were able to enter into non-margining interest rate swap agreements to hedge interest rate risk of bonds and mortgage-backed securities, would you expect banks would have been more willing to hedge?*

Response: The NCUA defers to the banking regulators for a response given their expertise on such matters.

7. *If accounting rules were changed to allow more flexibility regarding rules pertaining to hedge accounting, would you expect this to increase a bank's willingness to hedge*?

Response: Flexibility exists regardless of GAAP requirements. Financial reporting focuses on presenting the economic position of the entity. Hedging activities, if needed, should be conducted irrespective of the classification of debt securities, letting the financial reporting follow the entity's activities which may include reclassifying held-to-maturity debt securities to available for sale.

8. *Would you agree that, in the case of banks, a Treasury bond or mortgage-backed security whose interest rate risk is effectively hedged poses limited risk and should therefore be exempt from clearing requirements under Dodd-Frank? Please explain in detail.*

Response: The purpose and effectiveness of a hedging transaction executed by a financial institution is incumbent on the risk management capabilities of staff. The individual transactions used as hedged and hedging items are not a concern for the derivative counterparty as long as the clearing rules for margining are maintained. An exemption from the clearing requirements would not protect the clearing members from loss for these securities.

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Subcommittee on Financial Institutions and Monetary Policy Chairman, Andy Barr:

1. *Would you describe the NCUA's authority to address climate change*?

   Response: As a regulator and insurer of federal financial institutions, the NCUA has a statutory duty to ensure the institutions it oversees remain resilient against all material risks, including financial risks associated with climate change. Climate-related financial risks, including physical and transition risks, can manifest as traditional financial risks, such as credit, liquidity, market, and operational risks. Weaknesses in how a credit union identifies, measures, monitors, and mitigates physical and transition risks could adversely affect a credit union's safety and soundness and have implications for the NCUA Share Insurance Fund.

2. *What are the NCUA's plans to use the information it is currently requesting on "current and future climate and natural disaster risks to federally insured credit unions, related entities, their members, and the National Credit Union Share Insurance Fund?"*

   Response: The NCUA's goals in issuing the request for information are two-fold. First, the agency seeks to improve its understanding of climate-related financial risks, how credit unions view those risks, and how it can best support the industry in mitigating them. Second, the agency aims to better understand the products and services credit unions can offer to leverage opportunities presented by the transition to clean energy.

   As noted in the request for information, the NCUA has not made plans to use the information collected in the examination and supervision of individual credit unions. Any new requirements for credit unions associated with climate-related financial risk that would require changes to our regulations or examination and supervision procedures would be subject to Board action and approval before implementation, and proposed regulations would be subject to the notice and comment process.

3. *Is the NCUA's recent efforts on climate and natural disaster risks driven by an Executive Order of the President, or by interagency working groups established by Executive Branch officials?*

   Response: The NCUA's efforts on climate and natural disaster risks pre-date the Executive Order on Climate-Related Financial Risk issued on May 20, 2021. Initial work to understand these risks was started at the NCUA in early 2021, with the formation of a discussion group to consider the agency's supervisory structure for assessing climate-related financial risks. The NCUA Climate-related Financial Risks working group was a product of this effort. Several members of the NCUA working group are also members of the Financial Stability Oversight Council Climate-related Financial Risk Committee (CFRC).

Questions for The Honorable Todd M. Harper, Chair, National Credit Union Administration, from Rep. John Rose:

On January 3rd of this year, the OCC, Fed, and FDIC jointly released a statement highlighting a broad variety of concerns about banking crypto and potential associated risks. That statement was followed by another release from the same regulators on February 23rd with similar concerns, specifically suggesting that crypto deposits are more volatile than other types of deposits.

Noticeably, the NCUA did not sign on to these statements. That's the right thing to do and I was very happy to see it.

1. *Chairman Harper, could you discuss the rationale behind that?*

   Response: These two joint statements were not interagency guidance, and the NCUA did not participate in drafting or issuing these documents.

2. *Will you commit to continue serving all industries regardless of politicization, unlike your colleagues also on the panel today?*

   Response: The NCUA encourages federally insured credit unions to offer financial services to their members in a safe, fair, and equitable manner. This includes offering services to member-owned businesses that offer legal products and services, regardless of political affiliation.

Answers to Questions for the Record Following a Hearing entitled "Oversight of Prudential Regulators" conducted by the House Committee on Financial Services

On May 16, 2023, the Committee on Financial Services convened a hearing at which Michael J. Hsu, Acting Comptroller of the Currency, testified on "Oversight of Prudential Regulators." 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.

Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Rep. Alex Mooney

1. Are the clearing mandates of Dodd Frank in combination with the Held to Maturity accounting rules largely to blame for banks' failure to hedge?

   Response: We have not observed, including through the supervisory process, that clearing mandates in combination with Held to Maturity (HTM) accounting rules have been a primary obstacle for banks to hedge. The decision to hedge is complex and dependent on various factors such as the bank's risk management strategy and cost considerations among other factors. While clearing mandates and HTM holdings may play a role in decisions to hedge or not to hedge, they are just a few factors among many that influence a bank's decision to hedge.

- Does cash flow risk associated with mandatory margin requirements conflict with a bank's effort to reduce interest rate risk? In other words, if a bank were to fully hedge interest rate risk, would they then be exposed to substantial cash flow risk from the risk of mandatory margin requirements?

  Response: We have not observed that margin demands are hindering a bank's ability to hedge interest rate risk. A bank's strategy for hedging interest rate risk is influenced by many factors including but not limited to the bank's risk management strategies, portfolio composition, and cost of hedging and margining. Each bank's situation differs, and it is essential for banks to carefully assess and manage potential risks considering their individual strategy and risk appetite.

2. Does Held to Maturity (HTM) accounting treatment reduce a bank's incentive to hedge against interest rate risk?

   Response: In our view, the effect of certain accounting rules generally is not a driver in a bank's decision to enter into hedges. Decisions to enter into hedges for all exposures, including HTM securities, are largely based on a bank's overall risk management strategy. Bank strategies for HTM versus Available for Sale (AFS) accounting should include a wider range of considerations not limited to interest rate risk, but also including risks and needs such as strategic, earnings, counterparty and liquidity.

- Specifically, as HTM accounting treatment requires that banks report assets at amortized book value, it creates an appearance of price stability when in fact the fair market value of the assets may be changing substantially. Does this ability to hide price volatility reduce a bank's incentive to hedge?

Response: In our view, the accounting requirement to measure HTM securities at amortized cost on the balance sheet generally does not affect a bank's decision to hedge. Banks are required to disclose the fair value of HTM securities in the footnotes to the financial statements as well as in the Consolidated Reports of Condition and Income (Call Report). As such, any changes in the securities' value are transparent to users of the financial statements and the Call Report.

- Held to Maturity (HTM) accounting treatment does not permit hedge accounting; hence, when a bank decides to apply HTM status, they are committing to forgo hedging, correct? Please provide your view on this tradeoff.

Response: Securities that are classified as HTM are not eligible for hedge accounting treatment as such treatment is inconsistent with the HTM classification. A security is permitted to be classified as HTM if management has both the intent and ability to hold the security to maturity. Given its intent to hold to maturity, management's primary concern is the collection of contractual cash flows rather than changes in fair value due to the market interest rate changes. Applying hedge accounting would be contradictory to management's assertion that it has the intent and ability to hold the security to maturity.

In addition to the accounting limitations, holding HTM securities does not necessarily mean that banks are not hedging in other ways using their balance sheet, through means such as repricing/maturity laddering, funding decisions, and asset terms.

- Finally, please also comment on the risk of needing to mark to market all assets within an HTM portfolio when part of the portfolio is written down or moved to the Available for Sale category. How does this accounting "penalty" impact a bank's willingness or ability to liquidate assets when economically it would be necessary or beneficial.

Response: By designating the security as HTM, management is asserting that it does not expect it will be necessary to liquidate the asset nor will it do so even if economically beneficial. Generally, if a bank sells an HTM security, it calls into question management's intent and ability to hold the remaining HTM securities until maturity. As such, classifying the remaining securities as HTM may no longer be appropriate, and the HTM securities may need to be transferred to the AFS category which requires fair value measurement. This outcome is consistent with the requirement to classify securities based on management's intent and

ability to hold the securities. That is, securities that may need to be liquidated prior to maturity should not be classified as HTM.

We expect considerations of potential impacts to funding availability from HTM designations to be a consideration as part of a larger liquidity risk management program. Risk management should identify and understand liquidity limitations associated with HTM securities and have operationally ready sources (e.g., repo or other borrowing lines) to cost effectively monetize these securities, if needed.

3. If banks were able to enter into non-margining interest rate swap agreements to hedge interest rate risk of bonds and mortgage-backed securities, would you expect banks would have been more willing to hedge?

   Response: Currently, there is no evidence to suggest a direct correlation between margining requirements and banks' willingness to hedge. Even though margining has inherent cost associated with it, it also reduces counterparty credit risk in the financial system. The decision to hedge is influenced by various factors, including the bank's risk management strategies and the specific characteristics of their portfolios. While non-margining swap agreements could potentially provide added incentive to hedge, the willingness to hedge would depend on a range of considerations that are unique to the bank.

4. If accounting rules were changed to allow more flexibility regarding rules pertaining to hedge accounting, would you expect this to increase a bank's willingness to hedge?

   Response: We do not believe changes to hedge accounting rules would generally affect a bank's decision to enter into hedges.

5. Would you agree that, in the case of banks, a Treasury bond or mortgage-backed Security whose interest rate risk is effectively hedged poses limited risk and should therefore be exempt from clearing requirements under Dodd-Frank? Please explain in detail.

   Response: The margining requirement serves the purpose of mitigating counterparty risk associated with derivatives transactions, including interest rate swaps commonly used for hedging interest rate risk. Various margining requirements are implemented to ensure that counterparty risk in the financial system is collateralized. This includes margining requirements for trades cleared through central clearing counterparties (CCPs) as mandated, as well as margin requirements for non-cleared swaps. Additionally, individual banks may choose to impose additional margin based on their risk management strategies. Even if there is no specific clearing mandate for certain hedged instruments, those swaps may still be subject to margin requirements for non-cleared swaps. It is important to consider a broad range of factors when making decisions about hedging, rather than solely focusing on the cost of margining.

Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Rep. Young Kim

Mr. Hsu: In a bulletin issued April 26, the OCC stated that it has "identified concerns" with the charging of multiple NsSF fees for represented transactions, "resulting in findings in some instances that the practice was unfair and deceptive."

1. Has the OCC cited a bank for "unfairness" or "deception" for the bank's approach to charging multiple NSF fees for represented transactions?

   Response: The OCC reviews OCC-supervised banks for overdraft practices that may present compliance risks, including potential violations of section 5 of the Federal Trade Commission Act (FTC Act), which prohibits unfair and deceptive acts and practices. The OCC has cited OCC-supervised banks for violations of section 5 of the FTC Act for both unfair and deceptive acts and practices relating to the assessment of multiple fees associated with represented transactions.

2. To cite a practice as being "unfair," it must not be "reasonably avoidable by consumers." In this case, consumers can avoid being charged 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. Aren't I correct that consumers can avoid incurring multiple NSF fees by receiving notice from their bank of the first NSF fee and then replenishing their account?

   Response: The OCC considers the three factors set out in OCC Advisory Letter 2002-3, derived from principles described by the Federal Trade Commission (FTC),[1] to determine if a practice is unfair and thereby unlawful under section 5 of the FTC Act: whether (1) the practice causes or is likely to cause substantial consumer injury, (2) the injury is not outweighed by benefits to the consumer or to competition, and (3) the injury caused by the practice is one that consumers could not reasonably have avoided. All three factors must be met for a finding of unfairness. OCC considers each of these factors based on the specific facts and circumstances presented.

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[1] The OCC's framework for unfairness is guided by the FTC Policy Statement on Unfairness. *See* OCC Advisory Letter 2002-3, *Guidance on Unfair or Deceptive Acts or Practices*, p. 4, n. 5 (March 22, 2002) (citing FTC Policy Statement on Unfairness (Dec. 17, 1980), *available at* http://www.ftc.gov/bcp/policystmt/ad-unfair.htm)). The three-part test for unfairness is codified at 15 U.S.C. § 45(n).

Questions for Mr. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency, from Rep. Andy Barr

1. To date, none of the banks that failed were subject to OCC supervision. For a long time, you were senior staff at the Federal Reserve Board in supervision. Is there something that the OCC is doing differently in its supervision from the Fed and the FDIC, and something that you could characterize as OCC "culture" that may or may not somehow differ from Federal Reserve "culture"?

   Response: The OCC is singularly focused on its core mission 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. We work closely with other regulators to support and augment our supervision in line with our core mission.

2. Mergers and acquisitions ensure that we do not have a barbell banking system with a number of small banks and a number of GSIB banks, but no healthy mid-size bank sector in the middle. Does your agency recognize the importance of mergers for the diversity and strength of the financial system? Can you commit to complying with the timelines given to you in statute to either approve or deny a merger application?

   Response: The OCC recognizes the importance of preserving the diversity of the banking system, including the community, regional, and midsize banks that play an invaluable role in supporting the extraordinarily diverse range of economies, small businesses, and individuals across the country. The OCC follows applicable law and related standards, including the Bank Merger Act and the OCC's implementing regulations and procedures, when considering merger proposals. The OCC is committed to acting on merger applications consistent with these legal requirements and in a timely manner.