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OVERSIGHT OF FINANCIAL REGULATORS

HEARING

BEFORE THE

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

ONE HUNDRED SIXTEENTH CONGRESS

FIRST SESSION

ON

EXAMINING THE EFFORTS, ACTIVITIES, OBJECTIVES, AND PLANS OF FEDERAL FINANCIAL REGULATORY AGENCIES WITH RESPECT TO REGULATORY AND SUPERVISORY ACTIVITIES FOR FINANCIAL INSTITUTIONS, CREDIT UNIONS, AND ENTITIES

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C O N T E N T S

THURSDAY, DECEMBER 5, 2019

WITNESSES

Additional Material Supplied for the Record

OVERSIGHT OF FINANCIAL REGULATORS

THURSDAY, DECEMBER 5, 2019

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

The Committee met at 10 a.m. in room SD–538, Dirksen Senate Office Building, Hon. Mike Crapo, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN MIKE CRAPO

Chairman CRAPO. The Committee will come to order.

Today we will receive testimony from the Honorable Randal Quarles, Federal Reserve Vice Chairman for Supervision; the Honorable Jelena McWilliams, Chairman of the FDIC; and the Honorable Rodney Hood, Chairman of the NCUA. Welcome to all of you.

This hearing provides the Committee an opportunity to examine the current state of and recent activities related to the regulatory and supervisory activities of these agencies.

It has been over a year now since the enactment of S. 2155, the Economic Growth, Regulatory Relief, and Consumer Protection Act, and the work of the agencies to implement most of the law's provisions, including the tailoring rules for U.S. banks and U.S. operations of foreign banks.

Your agencies should also carefully review the existing supervisory frameworks and make any necessary adjustments to appropriately align them with the tailoring rules and requirements.

On July 30, 2019, all of the Republican Banking Committee Members and I sent a letter to the Federal banking regulators urging your agencies to finalize several outstanding provisions of S. 2155, such as the Community Bank Leverage Ratio and short-form call reports, and further tailor regulations to promote economic growth, including addressing the Current Expected Credit Losses accounting standard, the Volcker Rule, the inter-affiliate margin, and Madden.

Thank you for acting on many of these priorities. I encourage you to continue exploring additional opportunities to tailor these rules.

In that July letter, as well as an October 2018 letter to your agencies, several Banking Committee Republicans and I urged your agencies to revise the Volcker Rule, including using your discretion granted by Congress to address the current "covered funds" overly broad definition.

Although your agencies have joined the SEC and CFTC to issue a proposal revising several aspects of the Volcker Rule, which is appreciated, the "covered funds" provision was left relatively untouched.

I encourage your agencies to take quick action to address the "covered funds" issue by revising the definition's overly broad application to venture capital, other long-term investments, and loan creation.

Separately, in September, short-term borrowing rates spiked as a result of a large corporate tax payment coming due and $300 billion in Treasurys hitting the market, even in light of banks holding a surplus of cash at the Fed, currently around $1.4 trillion.

In light of these events, banks could have stepped in to alleviate the volatility in those markets by lending some of the excess cash that they hold at the Fed. So why didn't they do that?

Some have suggested that certain aspects of the Fed's supervision and regulations imposed after the 2008 financial crisis may have exacerbated this problem, specifically the treatment of cash versus Treasurys.

Although the Fed has taken some steps to address the issue in the short term by buying Treasurys and lending funds, it is important that the Fed review the details of its current regulatory and supervisory regime for potential long-term fixes.

Now, quickly turning to guidance, Senators Tillis, Perdue, Rounds, Cramer, and I wrote to the GAO in February asking for its legal opinion as to whether three Federal Reserve Supervision and Regulation Letters constitute a rule under the Congressional Review Act.

In its October response, GAO concluded that two of the letters, including one providing a new supervision framework for large financial institutions and another related to recovery planning, are rules under the CRA and are required to be submitted to Congress for review.

During the Banking Committee's April hearing on this very issue, I urged your agencies to follow the CRA and submit all rules to Congress, even if they have not gone through a formal notice-and-comment rulemaking to continue providing more clarity about the applicability of guidance.

I encourage the Federal banking regulators to take a more deliberate approach going forward and take any necessary steps to rectify informal guidance that has not been submitted to Congress.

In January 2019, the NCUA announced the portion of regulations that would be reviewed as a part of the process through which the agency reexamines all of its existing regulations every 3 years.

The comment period for that review process has since closed, and I look forward to learning more about the regulatory recommendations provided to the NCUA and the road map for actions going forward.

Finally, the Banking Committee has been exploring digital currencies over the last few Congresses, especially in light of the recent development of the Libra digital currency, started by Facebook.

In July, I asked Federal Reserve Chairman Powell about his understanding of and the Fed's role in the project.

Although Chairman Powell noted that the Fed has set up a working group to focus on Libra and is in contact with the other regulatory agencies, he also said that, "There is not any one agency that can stand up and have oversight over this."

Given its scope, regulators across the globe continue to evaluate Libra, its potential impact in the marketplace, and consider appropriate and necessary regulatory responses.

It seems that digital currencies are inevitable, and the United States needs to lead by providing clear rules of the road.

During this hearing, I look forward to learning more about the status of addressing the overly broad covered funds definitions in the Volcker Rule, especially with respect to long-term investments; how the agencies are thinking through the recent turmoil in the repo market, and what adjustments may be appropriate for a long-term fix; whether the supervisory framework that applies to banks currently needs to be updated to better reflect changes made in the tailoring rules; and how the agencies are thinking about the Libra project digital currencies, including what the U.S. regulatory framework merits consideration to balance innovation and protect users and privacy.

I thank each of you for your willingness to join the Committee today to discuss your agencies' regulatory and supervisory activities and these important issues.

Senator Brown.

OPENING STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman. Welcome to the three regulators here.

I want to start by noting that typically when we have the financial regulators testify, the Comptroller of the Currency is also here. Mr. Otting had a conflict today. I believe him. He is expected to announce changes to the Community Reinvestment Act shortly, changes that the civil rights community and others are very concerned about. I share those concerns. I expect that we will have him up before this Committee, Mr. Chairman, to talk about this proposal and other activities at the OCC soon.

We all saw how Wall Street's financial schemes hurt regular people when they blow up in bankers' faces, like they did 11 years ago.

You all saw the devastation of the crisis. Whether you were a staffer in the Senate, whether you were serving at the agency you now lead, or whether you were at a private equity firm after a stint at Treasury, you had a front-row seat. You can argue about or discuss responsibility. We can talk about that later.

That is why I am concerned about the collective amnesia you all appear to have as you make changes in bank rules—changes that allow Wall Street to go back to its old tricks that I fear will again cost Americans their jobs, their homes, their life savings, and wreak the kind of devastation in neighborhoods like mine in Cleveland the next time that complicated bets blow up in bankers' faces.

But what is sometimes harder to see are the schemes that hurt families and the economy even when they work exactly the way Wall Street intended them to work.

My State is the setting of one of those Wall Street schemes. Twelve years ago, just before the financial crisis, a giant private equity firm bought a nursing home company based in Toledo, Ohio, that operated facilities nationwide.

Soon that nursing home company was being strangled by debt from risky leveraged loans. It laid off hundreds of staff. It let its patients suffer under negligent, horrifying conditions.

According to the Washington Post, staffing cuts meant there were not enough nurses to respond to patients.

Health code violations rose dramatically.

In Pennsylvania, a patient broke her hip and crashed to the floor when a single staffer tried to do a two-person job and move her on his own.

Patients faced other living conditions that no human should have to endure, waiting in soiled clothing and dirty beds for help that was never going to come.

And all the while, that Wall Street private equity firm was extracting more and more profits.

Last year, the nursing home company went bankrupt. That did not stop the private equity firm from making huge profits on their investment.

That is what happens when leveraged loans, collateralized loan obligations, and leveraged buyouts work as designed, designed by Wall Street. Wall Street extracts the profits out of the company; the rest of us—workers, patients, families, and communities—pay for it.

Today Wall Street looks for profits anywhere it can find them. These schemes squeeze money out of every part of the economy. It is not only health care. It may be a hospital in Philadelphia, Pennsylvania, or it may be a hospital in Massillon, Ohio; but it is also manufactured home communities in Iowa—and I have seen some of those where private equity came in and raised the rent 50 percent, and people are captive, having to live there and much higher rent that they did not expect. Manufactured-home communities in New Hampshire also, not just harming individual families but entire communities.

Imagine how bad it will be if these complex financial transactions blow up like the subprime mortgages did in 2008.

This is just one of so many challenges working families face.

We got a report this week showing that almost half of American workers are stuck in low-wage jobs. One-in-four families spend more than half their income on rent and utilities. I know people sing about this economy, but think of this 10-year economy where growth has actually declined a bit in the last couple of years. Think about that. Almost half of American workers are stuck in low-wage jobs. One-in-four families spend more than half their income in rent and utilities, and you know what that means. If one thing goes bad in their lives, they lose their home. Forty percent of Americans are so short on cash they would be forced to borrow money to cover a $400 expense. Those are the people the three of you work for. You do not work for this President. You do not work for Wall Street. You do not work for the banks. You work in part for half the population that cannot come up with—40 percent of the population that cannot come up with $400.

More and more families have to borrow just to get by—credit card debt, student loan debt, and mortgage debt, all higher than before the crisis. Wall Street squeezes more out of every one of their paycheck, adding to their billions.

If regular Americans are struggling 10 years into this so-called recovery, when the stock market is booming, what will happen when there is a recession?

This cannot be how the financial system should work.

The regulators' job is not to protect profits for big banks and big companies. It is to protect our economy and our financial system and the ordinary families that the system is supposed to serve, not the other way around.

I guess when the President, when Candidate Trump talked about "draining the swamp," he really meant betraying workers and giving Wall Street free rein, as we have seen begin to happen, betraying workers and giving Wall Street free rein to prey on them and wring every last cent out of our communities.

The President uses his phony populism—racism, anti-Semitism, anti-immigrant slander—to divide us, to distract from all the ways he and his hand-picked cronies have betrayed working families and left them struggling more than ever.

That is not how a democracy should function. I am deeply worried that if you as the regulator do not stand up for workers and families, so much in our economy and our democracy is at risk.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

We will now turn to our witnesses, and I would ask you to give your remarks in the order I introduced you. We will turn to you first, Mr. Quarles.

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

Mr. QUARLES. Thank you very much. Chairman Crapo, Ranking Member Brown, Members of the Committee, thank you for the opportunity to appear today.

My colleagues and I join you on the cusp of a significant and shared milestone, which is the full and faithful implementation of Congress' efforts to improve financial regulation in the form of the Economic Growth, Regulatory Relief, and Consumer Protection Act. Today I will briefly review the steps we have taken toward this milestone, share information on the state of the banking system, and discuss the continuing need to ensure our regulatory framework is both coherent and effective.

The Act was an effort to consolidate a decade of work on financial reform and a specific targeted response to the conditions facing today's banking organizations and their customers. It was also rooted, however, in longstanding congressional practice of reviewing the work done in the immediate aftermath of a crisis, of addressing any gaps, and of ensuring that public and private resources go toward their best and most efficient use.

The Board's latest Supervision and Regulation Report, which is delivered in connection with my testimony today, confirms that we have a stable, healthy, and resilient banking sector, with robust capital and liquidity positions, stable loan performance and strong loan growth, steady improvements in safety and soundness, and several areas of continued supervisory focus, including operational resiliency and cyber-related risks.

The banking system is substantially better prepared to manage unexpected shocks today than it was before the financial crisis. And now, when the waters are relatively calm, is the right time to examine the efficiency and effectiveness of our protection against future storms.

With last year's reform legislation, Congress made a significant downpayment on that task, and in less than 18 months after the Act's passage, we have implemented all of its major provisions.

Earlier this year, we completed a cornerstone of the legislation, tailoring our rules for regional banks, and building on our existing work that firms with greater risks should meet higher standards and receive more scrutiny. We previously relied heavily on a firm's total assets as a proxy for those risks and for the costs that the financial system would incur if a firm failed. This simple asset proxy was clear and critical, was rough and ready. It was neither risk-sensitive nor complete. Our new rules employ a broader set of indicators to assess the need for greater supervisory scrutiny and maintain the most stringent requirements and strictest oversight for the largest and most complex firms.

We and our interagency colleagues have also worked on a range of measures to address the issues facing smaller banks, with particular attention to the community bank business model. And our goal through this period of intense regulatory activity has been to faithfully implement Congress' instructions, but those instructions also speak to a broader need and one central to our ongoing work, which is to ensure that our regulatory regime is not only simple and efficient and transparent, but also coherent and effective.

Financial regulation, like any area of policy, is a product of history. Each component dates from a particular time and place, and it was designed, debated, enacted to address a particular set of needs. No rule can ever be truly evergreen. Gaps and areas for improvement will always reveal themselves over time. Our responsibility is to address those gaps without creating new ones, to understand fully the interaction among regulations, to reduce complexity where that is possible, and to ensure that our entire rule book supports the safety, stability, and strength of the financial system.

My colleagues and I are paying particular attention to coherence in our capital regime and in the full set of post-crisis reforms, to a smooth transition away from LIBOR and other legacy benchmark rates, to sensible treatment of new financial products and technologies, and to clear, consistent supervisory communication which reflects and reinforces our regulations and laws.

My written testimony and the accompanying Supervision and Regulation Report cover each of these areas in greater detail, and I appreciate the opportunity to discuss them with you today.

Thank you, and I look forward to answering your questions.

Chairman CRAPO. Thank you very much.

Chair McWilliams.

STATEMENT OF JELENA MCWILLIAMS, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. MCWILLIAMS. Chairman Crapo, Ranking Member Brown, Members of the Committee, and fellow staff, thank you for the opportunity to testify today.

Eighteen months ago, I began serving as the 21st Chairman of the FDIC. During this period, the FDIC has undertaken a great amount of work with a particular emphasis on three overarching goals: strengthening the banking system as it continues to evolve; ensuring that FDIC-supervised institutions can meet the needs of consumers and businesses; and fostering technology solutions and encouraging innovation at community banks and the FDIC.

The FDIC has made significant progress in each of these areas, and I appreciate the opportunity to share our progress with this Committee.

Before discussing the FDIC's work to strengthen the banking system, I would like to begin by providing context regarding the current state of the industry.

The U.S. banking industry has enjoyed an extended period of positive economic growth. In July, this expansion became the longest on record in the United States. By nearly every metric, the banking industry is strong and well positioned to continue supporting the United States economy.

While the state of the banking system remains strong, the FDIC is continuing to monitor changes in the industry and work to further strengthen the banking system by: modernizing our approach to supervision, including outdated regulations and increasing transparency; enhancing resolution preparedness; assessing new and emerging risks; and creating the workforce of the future. My written statement details the many actions the FDIC has taken in each of these areas.

While these efforts are steps toward a stronger banking system, there are certain areas in which the needs of consumers and businesses must be addressed by more comprehensive reforms. We have been working diligently to update our regulations governing brokered deposits, which were put in place over 30 years ago. In addition, we are working with our fellow regulators to modernize the Community Reinvestment Act and provide clarity for banks seeking to offer loans that meet consumers' small-dollar credit needs.

Finally, perhaps no issue is more important or more central to the future of banking—and, frankly, to the present—than innovation. Technology is transforming the business of banking, both in the way consumers interact with their banks and the way banks do business. Regulators cannot play "catch up," but must be proactive in engaging with stakeholders, including banks, consumer groups, trade associations, and technology companies, to understand and help foster the safe adoption of technology across the banking system, especially at community banks.

Since 1933, the FDIC has played a vital role in maintaining stability and public confidence in the Nation's financial system. This mission remains as critical today as it was 86 years ago; but if we are to achieve our mission in the modern financial environment, the agency cannot be stagnant.

Last year, I began a 50-State listening tour to engage with State regulators, FDIC-regulated institutions, consumers, and other stakeholders. At the outset of this effort, I emphasized the need to reverse the trend of having those affected by our regulations come to Washington to have their voices heard, and instead to go and meet with them on their home turf. With 26 State visits in 18 months, I am now more than halfway through this listening tour, which has been incredibly informative and has underscored the importance of seeking perspectives outside of the Washington beltway. I look forward to visiting the remaining States and learning more about the issues that matter most to consumers and communities across the Nation.

Thank you again for the opportunity to testify today, and I look forward to your questions.

CHAIRMAN CRAPO. Thank you.

STATEMENT OF RODNEY E. HOOD, CHAIRMAN, NATIONAL CREDIT UNION ASSOCIATION

Mr. HOOD. Chairman Crapo, Ranking Member Brown, and Members of the Committee, as the 11th Chairman of the National Credit Union Administration, I am honored to appear before you this morning, and thank you for the invitation. I have written a very detailed statement that you all have for the record, but in my brief moment to speak with you this morning for my opening comments, I would like to talk about three areas where I think we have mutual interests. One is the current state of the credit union system; second, I would like to talk about NCUA efforts to foster greater financial inclusion; and then, third, I would like to talk about cybersecurity.

Ladies and gentlemen of the Committee, strong growth trends in federally insured credit unions are continuing in 2019. Roughly 119 million members are part of America's credit union system today. That accounts for roughly one-third of America being a part of a credit union. Credit union assets approximate $1.54 trillion through the end of the third quarter of 2019. Credit unions have also recorded a very strong aggregate net worth ratio of 11.39 percent, roughly 400 basis points above the 7-percent statutory requirement.

The Credit Union Share Insurance Fund is also healthy at this time, with roughly assets of $16.7 billion, well above the $10 billion level that the fund was at just over a decade ago. We also have posted a very strong equity ratio. Overall, year-to-date operating results evidence a very healthy and solid Federal credit union system.

I would now, ladies and gentlemen, like to talk about NCUA's efforts to foster greater financial inclusion. I deeply believe that financial inclusion is indeed the civil rights issue of our time. Inclusion means not only broader access to financial services, but also to employment and business opportunities. We at NCUA have just launched the Second Chance Initiative where our board voted on that final rule just recently for nonviolent criminal offenders to have employment opportunities with credit unions. This creates opportunities for these individuals to climb the economic ladder and have opportunities for greater financial inclusion and shared prosperity.

I agree with you, Senator Brown. It is troubling to read in a recent Federal Reserve survey that nearly 40 percent of American households cannot afford to pay for a $400 emergency. Even more troubling is that that percentage increases to 60 percent for families with a disability. This is why I am definitely pleased that NCUA and its Board has approved PALs II, a short-term, small-dollar loan product that serves as a responsible alternative to pernicious payday loans. These loans that we are creating through the PALs program are often being coupled with our credit unions financial education, financial counseling, and coaching, further helping these individuals achieve access to broader financial services.

Rural America must also be involved and included in financial expansion and inclusion. That is why I am also pleased that NCUA has worked to provide guidance to the agriculture community to help individuals learn how to work with this emerging business trend and remind them of the importance of following the FinCEN guidance. Also, we recently provided regulatory relief regarding the Commercial Real Estate Appraisal Rule, increasing that appraisal requirement from $250,000 to $1 million in response to some of the rural communities not being able to get appraisals done in a timely manner.

Third, I would like to focus on cybersecurity. Cybersecurity is a high priority for my chairmanship. Cyber attacks are, indeed, an acute threat that we as regulators must combat and face every day. I care about this issue so passionately that I have appointed a senior adviser to advise me and the industry on how do we in the credit union industry safeguard our defense mechanisms and really go to the extra efforts to protect member-owner data. This individual who is spearheading this effort is also providing cybersecurity training and outreach to assist our small credit unions, also utilizing new tools to better assist our examiners on looking at the levels of preparation, of cybersecurity preparedness in our credit unions, and also working in concert with some of the other Federal regulators here today.

In closing, I would like to inform the Committee that we are very grateful and appreciative of the work that you all did in passing Senate bill 2155. I am also pleased to report that NCUA has met all of the provisions that retain to credit unions and especially the actions that we could take unilaterally. So if I look for opportunities to work with you in the days ahead, I would like to look for opportunities to promote greater financial inclusion, economic mobility, and shared prosperity in America's underserved areas.

Thank you.

CHAIRMAN CRAPO. Thank you very much, Mr. Hood. And as I begin my questions, I have got a lot of them, more than we will be able to cover in my 5 minutes, so I ask you—first of all, you should expect to get some written questions from me following the hearing; but, second, I ask you to be as precise as you can in your responses.

The first one is to Chairman Quarles and Chairman McWilliams, and I hope it will just require a yes answer quickly from both of you. It is on the covered funds issue, and I just wanted to ask if each of you—yes, got it already—if each of you would just commit that you will respond and resolve this issue quickly.

Ms. MCWILLIAMS. Yes.

Mr. QUARLES. Yes.

Chairman CRAPO. All right. Thank you. We have got a good start there.

Chairman McWilliams, on Madden, you indicated when the Madden decision came down that it has interjected uncertainty, significant uncertainty, into the secondary markets for loan sales in the Second Circuit and raises safety and security concerns. How does the FDIC's proposal address the confusion around the valid-when-made doctrine and support safety and soundness?

Ms. MCWILLIAMS. Thank you for that question. The FDIC's proposal basically does not change the framework we had before Madden. Since 1828, there was a Supreme Court precedent that basically said if a loan is not usurious when made, nothing subsequently makes that loan usurious. Congress gave national banks that treatment as well in 1865, and then 115 years later, in 1980, the FDIC got the opportunity to implement that into our statute. So we have had long existing guidance implementing basically exactly that. It is the so-called valid-when-made doctrine that the Court in Madden frankly ignored. They ignored almost 200 years of both regulatory and legal history.

And so we were compelled to provide clarity, restating what we have had in place since 1980 at the FDIC, and our proposal does not change anything that we have had since 1980.

The concern with Madden is that there are going to be implications for the secondary market that are frankly going to undermine safety and stability of the system and the soundness of our banks. If banks are unable to sell loans in the secondary market and have the sanctity of the contract carry over, there is going to be a disruption in the ability of the banks to basically be able to offload those loans if they need liquidity at a time of stress. And it is something that we from the regulatory perspective are quite concerned about.

Chairman CRAPO. All right. Thank you, and I appreciate your attention to this.

Ms. MCWILLIAMS. Thank you.

Chairman CRAPO. Mr. Hood, this summer you publicly stated that the NCUA Board intends to release a proposed rule to allow subordinated debt to be counted as regulatory capital for a broad range of credit unions by the end of the year. Can you provide the Committee with a quick update on your progress on this rulemaking?

Mr. HOOD. Yes, thank you for that question, Senator Crapo. This has proven to be a very complex issue, so we are still working diligently on the proposal because we really want to get it right. I really am, though, delighted that our aggregate network ratio for credit unions today is about 11.39 percent, so we really do have a strong capital position now, and I want to introduce other tools to further buttress that level of capital. But right now we are still studying that and making sure we get a proposal right before we give it to stakeholders for comment.

Chairman CRAPO. All right. Thank you, and I appreciate your attention to this as well.

Mr. HOOD. Yes, sir.

Chairman CRAPO. And finally, Mr. Quarles, we do not have nearly enough time left to get into this issue as deeply as I would like to, but I want to talk about digital currencies. I understand that you are basically the lead at the Fed on dealing with our other regulators around the globe and working with others as they look at Libra and, frankly, at the digital currency issue. Correct?

Mr. QUARLES. Yes, the G–20 has given the Financial Stability Board the task of considering the stablecoin issue, and as I chair the Financial Stability Board, that is my responsibility, yes.

Chairman CRAPO. Well, I am very concerned. You know, the Libra issue and Facebook presents one set of issues, but the digital currency issue is much broader, as I see it. And one of the big concerns I have is that the potential for digital currencies based on blockchain technology could ultimately undermine the role of the U.S. dollar in global markets. Do you share that concern?

Mr. QUARLES. I think that would be a very long-term concern if you consider the current proposals for stablecoins, those that rely on a basket of currencies to anchor their value include a very heavy weight toward the dollar just given the role of the dollar internationally currently, and that would not be likely to be the case for some time. But over a long period of time, that would be an issue we would need to think about.

Chairman CRAPO. Well, if other nations, for example, were to pursue that, wouldn't that give them the ability to basically try to start shifting away from the dollar to the utilization of other currencies?

Mr. QUARLES. If other currencies were more useful in the payment system or more useful forms of payments, again, I think it would not be an immediate effect, but over a long period of time, that would be a factor, yes.

Chairman CRAPO. All right. Well, thank you. My time is up. I have got a lot more I want to talk with you about this, so both in conversation as well as in questions. I will get further information to you on that. This is something I think we need to take a really deep dive on, and rapidly. So thank you.

Chairman CRAPO. Senator Brown.

Senator BROWN. And I would hope, Mr. Chairman, we can get a second round, too. Thank you.

The private equity firm I mentioned in my opening statement, Mr. Quarles, is the one that cut staff, the one that cut staff at nursing homes and documentation of endangering patients is your former employer, the Carlyle Group. You were a partner when this was happening, so I have to assume you were aware of it as Carlyle reaped huge profits from this.

Do you think a system that allowed the Carlyle Group to load up a company with debt and extract management fees and cut corners and put patients at risk is a good system?

Mr. QUARLES. I actually was not involved in that transaction at all, so not wanting to speak about the details of that transaction, I do think that it is important that we have a system where private equity is bringing benefits to the companies it invests in and not otherwise.

Senator BROWN. Not otherwise, meaning if they are not bringing benefits, thy should not be allowed to do it? What do you mean "not otherwise?"

Mr. QUARLES. We should have a system that creates incentives so that investors are improving the companies that they invest in.

Senator BROWN. So even though you—I mean, I heard your involvement in the Bush administration, you did not seem to be too responsible for the economy imploding in those years. And now you are saying you were at Carlyle—I mean, the Carlyle Group benefited financially a great deal in its takeover of that company, Manor Care, in Toledo. So I guess I would ask this then: What steps do you take now then at the Fed to rein in risks and make sure financial companies are investing in the real economy and creating jobs rather than this financialization and making reckless bets that hurt families?

Mr. QUARLES. Safety and soundness of the financial system is the responsibility of the Fed. That is an element of our supervision and examination of firms and I think an appropriate element.

Senator BROWN. That does not seem very proactive. I mention private equity because they are the biggest users of the riskiest kind of leveraged loans, as you know, which they dump on companies that they got for profits. It has been 6 months since I raised concerns in letters and in hearings over leveraged lending. You have shifted from it is not a problem, earlier answers, to we need more data.

What specific abuses that are not already happening in the leverage lending market would you have to see to convince you to crack down on these risks?

Mr. QUARLES. Well, we have taken supervisory action with respect to leverage lending, Senator. Earlier, it is not that we had said that it is not a problem. I think we have been trying to draw a distinction between is there a financial somebody risk versus is there a potential contribution to a future business cycle downturn of current underwriting practices.

With respect to the latter, a focus of the last two shared national credit examinations where all of the regulators together look at the largest loans that are shared among a number of institutions has focused—a focus has been leverage lending and the evolution of underwriting practices as to which we have had a concern. And I think they are familiar to most people here.

In the first cycle, we indicated which of those practices we had concerns about, and then in the second cycle, if they were continuing, we took appropriate supervisory action against the firms that were underwriting leveraged loans in this fashion.

Senator BROWN. I guess, Mr. Quarles, because of the background of you and other regulators, because of your experience prior to these jobs and your general support for Wall Street, I just do not share in the confidence that you are going to proactively do something about this. I mean, I understand you say if it is risk to the financial system, to the stability, that is one thing. But it is obviously more than that.

Let me shift to Chairman Hood, if I could for a moment. The NCUA is an independent Federal agency, right?

Mr. HOOD. Yes, sir.

Senator BROWN. Independent, OK. Do you agree that you as Chair of the NCUA must act without control or influence from the White House?

Mr. HOOD. I am deeply committed, sir, to maintaining NCUA's independence as a regulator.

Senator BROWN. From the White House?

Mr. HOOD. As an independent regulatory agency, it is my duty to uphold that.

Senator BROWN. Including from the White House?

Mr. HOOD. I am committed to ensuring that NCUA——

Senator BROWN. You do not seem to want to say yes to that. OK. I get it.

I sent you a letter in October because I was concerned about the photo ops you were doing with President Trump at the White House and at his golf course. Then I got this letter from your office this past Tuesday. Can you tell me who you were posing with in those pictures—in the first picture that you sent to us?

Mr. HOOD. I am sorry——

Senator BROWN. You have a picture right there. Can you tell us—it is a letter you sent us as a peculiar, perhaps, but a response. I am not sure if the letter is supposed to be a response to my concerns or not. So could you identify the people in that picture?

Mr. HOOD. Oh, these are speaking engagements. What I sent you, Senator Brown, was a listing of my activities in my first 6 months of meeting with stakeholders to talk about credit union issues, to foster greater financial inclusion and shared prosperity. There is a picture of me being sworn in, it looks like, with one of the leaders of the SBA, and then my swearing-in was conducted by the Vice President of the United States. But those are pictures showing stakeholder engagement, but then I also provided activities of the 7 months of activities where we have kept America's credit unions safe and sound, and the letter was meant to be an opportunity to meet with you to talk about regulatory accomplishments as well as any other issues you would like to discuss.

Senator BROWN. OK. I just am not sure you understand what "independent regulator" means from your letter back to us, from your statements about speaking as a body, from the NCUA as a body, and from your other activities with the President. So I hope the lesson you take from that, Chairman Hood, is that you are, in fact, independent from the person who appointed you, the Administration that sponsored you, from anybody that might have influence on you. Thank you.

Chairman CRAPO. Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman. Thank you all for being here, and thank you for giving so much to our country.

I would like to use my first couple of minutes, Madam Chair, talking to you about industrial loan companies. You know what those are. They are basically banks, but they are not regulated like other banks. They are authorized at the State level. Some of our largest companies are starting to use these industrial loan companies to take deposits, for example, and I think competition is good.

Competition is a moral good. But I worry that they are not regulated like the other banks, and I have a bill called the "Eliminating Corporate Shadow Banking Act" just to make sure that these industrial loan companies are on a level playing field with everybody else and are properly regulated, you know, not too hot, not too cold, just right.

Could you give me about a minute of your thoughts on that?

Ms. MCWILLIAMS. I have not had an opportunity to take a look at your bill, and as a former staffer——

Senator KENNEDY. It is a good one. Trust me.

[Laughter.]

Ms. MCWILLIAMS. I know your staff, and I believe it is probably a good bill. Congress gave us authorities to regulate ILCs, and, frankly, as we look at the ILCs, we only have a couple dozen ILCs in existence right now. The ILCs of the past are looking different than probably—well, the applications we are getting at this point in time, that is true.

At the depository institution level, Congress gave us ample authorities to regulate the ILCs, and when——

Senator KENNEDY. But they are not regulated the same as banks. Is that correct?

Ms. MCWILLIAMS. They have a different regulatory structure, so we regulate the depository institution that——

Senator KENNEDY. Why don't they just have the same regulatory structure? Wouldn't it save money if you did them all the same way, just economies of scale?

Ms. MCWILLIAMS. From the perspective of the depository institution, the ILC is regulated the same way as a bank. In fact, when Congress gave us authorities to approve deposit insurance for ILCs, it gave us the same statutory standards as it did for banks.

Senator KENNEDY. Let us talk further about this.

Ms. MCWILLIAMS. Sure.

Senator KENNEDY. I disagree with you on that. I do not think they are regulated the same, and I just do not understand why everybody is not treated the same.

I want to go to Chairman Quarles for a second. I think our community banks are doing very well in large part or in substantial part as a result of the work of most of the Members of this Committee when we passed Senate bill 2155. I am still concerned about our large banks. We all remember 2008. From my standpoint, in 2008 the leadership of some of our largest banks took their banks to Hell, and the Government rode shotgun.

They have not been tested. Our economy is much better, and it is still healthy, but we now at some point we will have a recession. I think had we not passed the Jobs and Tax Cuts Act, we would be in a recession now. I think it was Buffett who said, "You do not know who is swimming naked until the tide goes out."

Mr. Chair, do we still have banks that are too big to fail?

Mr. QUARLES. I think that the regulatory response, the post-crisis body of regulation, will have given future regulators in the event of stress at a large institution many more options than they had before to resolve that institution or to take other actions rather than bailing them out.

Senator KENNEDY. Do you think we still have banks that are too big to fail?

Mr. QUARLES. I think that the way that I look at that question is will regulators in the future, will the Government in the future, when it is faced with stress at a large institution, have an option other than providing support for the continued life of that institution. I think those options will exist, yes.

Senator KENNEDY. Will one of those options be come to Congress and we appropriate a bucketload of money to bail them out?

Mr. QUARLES. I hope that does not happen. The purpose of the framework is to ensure that regulators have options so they do not do that. But unless I am one of them, I will not be able to control their future actions as to what they might ask for. I would say now, however, that if they come up and ask you for that, you should be aware that they will have many other options in front of them than they had at the time of the last crisis.

Senator KENNEDY. OK. Thank you.

Chairman Hood, if you have a few minutes afterwards, I would like to get a photo, OK?

[Laughter.]

Chairman CRAPO. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Chair McWilliams, I understand that when you first came to the United States you only had $500 in your pocket.

Ms. MCWILLIAMS. I did.

Senator MENENDEZ. And you used that $500 to open a checking account and, importantly, get a secured credit card. You stated that, "With each swipe of that credit card, I felt more integrated into the very fiber of American society." So do banks get CRA credit for offering a secured credit card?

Ms. MCWILLIAMS. To tell you the truth, the answer is not that simple. You have to go through a complex formula to figure out what qualifies and not under the CRA, the current CRA——

Senator MENENDEZ. Well, let me share with you that, according to the Government Accountability Office, banks that offer secured credit cards designed to establish or rebuild credit histories receive credit under the CRA. So what we have here is a real-life example of someone benefiting from the CRA. You yourself said that this secured credit card opened up "a world of opportunities" for you. So I would hope that as you decide how to move forward on potential changes to the CRA, you will take to heart the need to strengthen the CRA so that more Americans can benefit from this important civil rights law just as you did when you first came to the United States.

So let me relay one concern I have with how things are going. Recently, Politico reported that the FDIC could give the smaller banks it regulates the choice of opting into this new OCC-led CRA regulatory framework or continuing to be examined under the current system. That could lead to a situation where banks themselves choose to participate in the model that gives them the best grade and not the one that best measures whether their activities are effectively addressing the needs of their communities.

If adopted, do you know what percentage of FDIC-regulated banks would have the choice to opt into the OCC approach?

Ms. MCWILLIAMS. So the proposal is still being worked on. One of the options we considered was the opt-out for small banks—I am sorry, opt-in, opting into the new regime or keeping the existing regime. The main reason for the opt-in opportunity would be to provide an ability for small banks not to have to change their reporting requirements and how they go through the analysis of what qualifies for the CRA.

The number of small banks, if they decide to opt in, would depend on what threshold we pick for the cutoff, so if they——

Senator MENENDEZ. So you do not know yet what number because you have not decided on the threshold?

Ms. MCWILLIAMS. It is not firm. We are looking at numbers and making sure——

Senator MENENDEZ. But I hope that other than—you know, we want small banks, yes, to have less necessity in terms of paperwork, but we do not want them to have less necessity or obligation in terms of creating a portal of opportunity under the CRA.

Ms. MCWILLIAMS. I agree with you.

Senator MENENDEZ. If most FDIC-regulated banks would be able to opt in, if that is what happens, then aren't you simply making a political calculation that best protects the interest of the banks you are charged with regulating over those who stand to benefit from a strong CRA rule? Isn't it in essence the threshold that will determine whether that is the reality or not?

Ms. MCWILLIAMS. No, actually, it is not. The reason that I am willing to consider reform to the Community Reinvestment Act is because the Act has not been revisited since 1995 by the regulators and Congress. You gave us the authority to take a look at the Act and make sure it serves its intended purpose. Currently, we have digital delivery channels for banks that are not necessarily accounted for appropriately in the current assessment areas. The way the deposit taking now takes place is everything gets attributed to a branch, and now with the digital channels, there is a lot of deposit taking that is taking place outside of this area, and we want to make sure that under the reform of the CRA, those areas where the digital banks are functioning and taking deposits and offering services are covered by the CRA.

Senator MENENDEZ. Well, let me just say that age itself is not a reason to review the Act. Certainly to improve and strengthen the Act is something worthy, but you do not want to at the end of the day use the time in which the Act has not been reviewed to weaken it. So I am concerned that you are all trying to have it both ways, not fully endorsing the flawed OCC plan that allows most of the FDIC-regulated banks to choose which system they are measured under, but also not standing up and fighting for a better CRA standard than what Comptroller Otting has proposed.

So I hope that the end result is that I am wrong on that, but I am going to be looking with incredible intensity.

Ms. MCWILLIAMS. I look forward to proving you wrong, Senator.

Senator MENENDEZ. I am always happy to be proven wrong when it is a benefit to consumers.

Vice Chair Quarles, 5 years ago—I want to follow up on comments that Senator Kennedy raised to you about banks—the regulators adopted the liquidity coverage ratio to require banks to hold additional capital that they could draw upon in a crisis and thereby reduce the risk of another taxpayer bailout. But in October, the Federal Reserve finalized a rule that would reduce the liquidity coverage ratio by 15 percent for big Wall Street banks.

Now, S. 2155 did not require the Federal Reserve to reduce the LCR, and the banking sector has not gone through a full economic cycle while the previous LCR rule was in place. So at a time in which we see record growth among the banks, the fantastic times, the banking sector reported $62 billion in profits in the second quarter of 2019, a 4.1-percent jump from 2018, why is now not the time to assure a bank's liquidity, not reduce it? We saw what happened in the repo market, and I have real concerns that instead of taking the moment of strength to strengthen the banks, you are just giving them more running room to get into trouble.

Mr. QUARLES. Do I have time to respond briefly, Chairman?

Chairman CRAPO. Yes, please. Briefly.

Mr. QUARLES. Thank you. So for the large Wall Street banks, we did not change their liquidity requirements at all. Those remain the same for the G–SIBs. S. 2155 did include—while it gave specific instructions for tailoring under 250, there was also a mandate, a "shall," that we would tailor for all institutions, and so for regional banks, not the large Wall Street banks but below that, we tailored their liquidity requirements, and then it goes down so that there are lower liquidity requirements for firms that pose even less risk to the financial sector.

So the concept of tailoring and I think the instruction in S. 2155 was to evaluate the risks that different categories of institutions posed to the financial sector and then tailor for each of those categories of institutions. It is not a dramatic reduction in liquidity. All of those institutions still have much, much more liquidity than they had before the crisis, and I do not think it is—and the largest institutions, the Wall Street banks, still have every bit of coverage under the LCR that they did before S. 2155.

Senator MENENDEZ. Well, I hope we do not have to revisit what we did in the Great Recession and then remind you of your comments that, instead of strengthening the liquidity reserves, we actually weakened them.

Chairman CRAPO. Senator Tillis.

Senator TILLIS. Thank you, Mr. Chairman.

Mr. Hood, it is great to see somebody that hails from my neck of the woods in North Carolina. I want to thank you for the work you have done on affordable housing long before you got into your current post, and it was all that work you did for the community that made me proud to have you a member of the Board of Governors. You were giving back to a great educational institution.

Mr. HOOD. Thank you.

Senator TILLIS. You do great work. I have got a picture with you, but I would be proud to have another one.

Mr. Quarles and Chair McWilliams——

Senator KENNEDY. I get to go first.

[Laughter.]

Senator TILLIS. First, I want to thank you all for the work and the progress that we are making on the inter-affiliate margin. It is going to free up, I think, almost $50 billion in capital. It is a long time coming. Somebody is going to have to work hard to make that a partisan issue since that is something that has been in place under Democrat and Republican administrations in the past, so thank you for that.

I want to go on to the Community Reinvestment Act and the update, and specifically, I know that the OCC is taking the lead. I should also say I am looking forward to the work on the Volcker Rule. I am trying to get this done and stay within my time, so I am talking fast.

On the rewrite, Chair Quarles, is the Fed going to play a role in the CRA rewrite along with the FDIC and the OCC?

Mr. QUARLES. We have been very actively engaged with the OCC and the FDIC in——

Senator TILLIS. At the Governor level?

Mr. QUARLES. At the Governor level, absolutely. We have been very actively engaged, and the proposal that is evolving has benefited from a lot of Fed input.

Senator TILLIS. Well, if you look at that, I do not think that that has been touched since about 1977? Is that about right? No, no, I am sorry. About 30 years.

Ms. MCWILLIAMS. It was 1995.

Senator TILLIS. So I was young back then, so hopefully we can take into account this thing, the Internet has come on board, online banking, and a number of other changes in the banking system that hopefully we can modernize, and I look forward to what you all do there.

Chair McWilliams, I wanted to ask you a question. You in particular took a fairly aggressive posture in going through and looking at all the clutter, guidances, one-off advisory letters, secret memos, facts that have long been used to regulate and supervise banks. Can you give me an idea of where we go from here?

Ms. MCWILLIAMS. When I took the office of Chairman at the FDIC, I frankly thought that we could do our supervision in a more transparent and accountable manner. You know, quite often we look at the regulations and instructions we give to companies, and I have been surprised at how many ways we communicate with the companies, our regulated entities, and not always make that a standard for everybody, but do one-off letters here and there. My goal for the staff at the FDIC has been to comb through and tell us what regulations need updating, and not only because of the passage of time but because technology has simply changed, and the way the banks do business has changed. We also need to take a look at whether we are being transparent and uniform in our application of the laws. And to the extent that we are not or that we have done things that are one-offs, I believe there is an opportunity for us to, you know, apply the good sunshine policy and go public, solicit public comment and move forward with rulemakings and guidances that are applicable to everybody and so people have a clear road map as to how to do business.

Senator TILLIS. Well, I appreciate the very thoughtful and assertive approach that you have used there. I think that it is a model that a number of regulatory agencies even outside of the banking space should take note of, because it is a way that we can take needless burdens off of business and put that back into making houses more affordable, making banking more affordable, and making the private sector grow.

Vice Chairman Quarles, you testified on the House side yesterday, and I believe you were asked about the concerns the private sector system could have in discriminatory pricing for the payment system. The private sector has made a commitment in writing to have flat pricing. If the Fed is concerned about discriminatory pricing, pricing that would disadvantage smaller banks, why has the Fed refused to make the same commitment to flat pricing for the FedNow platform? And why does that make sense?

Mr. QUARLES. So, as you know, Senator, the Federal Reserve, in connection with standing up operations in the payment system, is required by law to recover our costs, and I think as the proposal evolves and as we continue to develop the faster payment system that we have committed to undertake, we will have a better sense of exactly what will be required in order to recover all of those costs, and at that time we will be able to evaluate what the pricing will be.

Senator TILLIS. Thank you. I yield back 3 seconds.

Chairman CRAPO. Thank you.

Senator Warner.

Senator WARNER. Thank you, Mr. Chairman. Great to see the witnesses.

Vice Chairman Quarles, I want to start with you again and pick up on some of the line of questioning about CRA. I think you have been quoted as saying you feel like the CRA is a little formulaic and ossified, and I tend to agree that it is—you know, since 1995, I do not think we have taken a major look at how we need to be modernized.

I am concerned, as I think other colleagues are, with the notion that the OCC and the FDIC would move forward on a regulation without the Fed's impact, and I think that would be a huge mistake because we would leave a series of the community out.

Yesterday during the House Financial Services Committee, you were asked a question, but I do not think I got—at least in my review of the question, I did not get a full answer about whether you feel like you will be proceeding and will be participating in the OCC's modernization efforts. And I wish Comptroller Otting was here, where he has basically said he thought the Fed was not going to be involved.

So, for the record and for my colleagues, can you clear up whether you intend to have the Fed involved in this much-needed reform process?

Mr. QUARLES. Well, this is a continuing effort to look at CRA modernization. There is agreement among all the agencies as well as everyone who considers the issue—community groups, the banks, I think among many here—that the implementation of the Community Reinvestment Act can be improved given evolution in the banking industry and given, you know, as I have said, kind of the ossification of practice over time. The Federal Reserve is committed to that and has been working together with the other agencies as part of this process.

Now, the issue that is immediately at hand is when will a Notice of Proposed Rulemaking come out, but that is an interim step to any final rule. At the outset of the process, the OCC went forward independently of both the FDIC and the Fed with an Advance Notice of Proposed Rulemaking. We all benefited from the information that they received. The Fed also had a broad information-gathering process at all of our Reserve Banks. At the same time as that Advance Notice of Proposed Rulemaking was happening, the FDIC had its separate process. And all of that has come into now the consideration of the Notice of Proposed Rulemaking.

So while it has not 100 percent been decided yet whether at this next step, the Notice of Proposed Rulemaking, all three agencies will go together or some may go separately, in the same way as that first step was done separately by each of the agencies but it was all part of a joint process, I would not draw too much from if that is again one or two agencies going separately on the Notice of Proposed Rulemaking because we will continue to be working together on trying to get to a final rule, and my expectation is still that when we get to that final rule, it will be all three agencies together.

Senator WARNER. Because, you know, obviously if we have OCC and FDIC, you guys not involved, we end up with a new set of rules and regulations that would cover 80 percent of the market but not the very critical component that you guys cover, you know, we are not going to be able to bring that consistency modernization in what I think is a very, very important role that CRA plays.

Mr. QUARLES. I completely agree.

Senator WARNER. So I am going to take your answer as yes, you guys will be involved; there will not be a hodgepodge of rules; there will be a uniform final answer that will include all three regulatory agencies.

Mr. QUARLES. That is the objective.

Senator WARNER. OK. So that is a yes, as I tried to put as many words as possible in your mouth, it will be all three?

Mr. QUARLES. Well, "yes" would be one of the words that I would say. But, yes, that is the objective, that we are aiming to get to a final rule all together, and if it happens that the interim steps happen at different speeds, I would not draw too much from that.

Senator WARNER. One of the things that I know also is, in your role as chair of the Financial Stability Board, I know you have been conducting this in-depth analysis of CLOs, and obviously we have seen the numbers grow. We realize this has both a national but also international implication in terms of involved with the G–20. When do you think that study is going to be done? When we are going to get a chance to look at that?

Mr. QUARLES. We should be making that public very shortly, I think early in the new year. It is being circulated among the members of the Financial Stability Board, the results of it currently, for final sign-off.

Senator WARNER. My time has expired, although I could not get away without my colleagues being here and saying there is a broad bipartisan work being done on this Committee on what we call the "Illicit Cash Act," which deals with AML, beneficial ownership, I think issues that have been long in need of review. The Chair and the Ranking Member are going to, I know, take some of the work that we have done and buildupon it. My really strong hope is that we can move sooner than later on that really long overdue piece of reform and regulation.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Shelby.

Senator SHELBY. Thank you.

I will pose this question to all of you as regulators: What is your current assessment of the overall health of the U.S. financial system compared to conditions, say, in 2007–08? We will start with you, Chairman Quarles.

Mr. QUARLES. Absolutely. It is a much healthier banking system. We have significantly higher levels of capital and liquidity. We have a focus on the resolvability of institutions to address the too big to fail question that was not there before. Financially, it is much stronger.

Senator SHELBY. Chairman McWilliams?

Ms. MCWILLIAMS. Absolutely much stronger, both for the large banks and small banks. In the meantime, the regulators have put in a number of capital and liquidity rules on these banks, and the capital levels are at a healthier level than they were, a much healthier level than they were before the crisis.

Senator SHELBY. And what about the credit unions?

Mr. HOOD. Yes, Senator Shelby, the credit union system is strong and robust. I mentioned a lot of that in the opening remarks. Capital now is at 11.39 percent, far beyond the 7-percent capital requirement, and also we have a very strong Insurance Share Fund of $16.7 billion, which is far beyond the $10 billion coming out of the recession.

Senator SHELBY. As regulators, have any of you ever known a financial institution to fail, to go under, that is well capitalized, well managed, and well regulated?

Mr. QUARLES. It would be difficult for it to fail if it were well capitalized, absolutely.

Senator SHELBY. Well capitalized is important to the health of a situation, also liquidity, being liquid at times, right?

Mr. QUARLES. Exactly.

Senator SHELBY. Ms. McWilliams?

Ms. MCWILLIAMS. Nothing comes to mind.

Mr. HOOD. Nothing comes to mind at the moment.

Senator SHELBY. So there is no substitute for capital, in a sense, when something is under stress, or liquidity. Is that right?

Mr. QUARLES. Capital is key, although it is a useful factor of the post-crisis framework that we also focus on liquidity. But we do have that focus now on liquidity, and the two together are key.

Senator SHELBY. Would you say that the overall health of our banking system is as good as you have known it in the last 20 years or more?

Mr. QUARLES. I would go farther and say I think my career has lasted for about 35 years, and it is as good as it has been during that entire time—better, much better.

Senator SHELBY. Do you agree?

Ms. MCWILLIAMS. I agree, and I am fortunate to be the Chairman of the FDIC at this time.

Senator SHELBY. Well, I commend all of you for trying to keep it that way, too.

Vice Chairman Quarles, how do we maintain simplicity in financial regulation considering that the scope and complexity has just grown so much? How do you balance that?

Mr. QUARLES. So I think, you know, all the points that you have just raised, because we have such a resilient and strong financial sector now, we have the benefit to take some time and to look at the overall structure of regulation and to determine where we can make it simpler and more efficient while still maintaining that resilience.

One of the things we proposed at the Federal Reserve, for example, is to take our 24 different measures of loss absorbance, resiliency, various capital measures, TLAC, *et cetera,* and to combine them into our stress capital buffer that would be much simpler and yet retain exactly the same level of resiliency.

Senator SHELBY. Ms. McWilliams, do you have a comment on that?

Ms. MCWILLIAMS. I think it is important that we are able to maintain a level of liquidity and capital that functions well for the market and the financial stability overall. There is always a balance. It is a see-saw of how much capital and liquidity do you need versus how much should you release in the economy to ensure that the economy is stable, because in the end if the economy is not stable, these banks are not going to be stable. So there is a symbiotic relationship, and we are constantly monitoring the levels at which these banks need to be in terms of capital and liquidity. And to your prior question, I would add that it is capital, liquidity, and management. I believe good management is key to the success of a bank.

Senator SHELBY. Do you have a comment, sir?

Mr. HOOD. I was just going to say I agree with Chairwoman McWilliams wholeheartedly. It is about balancing capital with liquidity. Balance sheet management is key.

Senator SHELBY. Thank you for what you do.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Schatz.

Senator SCHATZ. Thank you, Mr. Chairman. Thank you all for being here.

Vice Chair Quarles, at the last oversight hearing, we talked about the financial risks caused by climate change, and we discussed the prospect of the Fed joining the group of now 42 central bankers and regulators thinking about and working on accurately accounting for the risks related to climate change. Do you have any updates on that?

Mr. QUARLES. Thank you, Senator. As we discussed, as I think I mentioned at that last hearing, we have been exploring—I wanted us to explore joining the Network for Greening the Financial System. For a variety of reasons under their charter, that requires some adjustments in order for us to join as an observer, but we are continuing to discuss with them how that can be done. In the meantime, we have attended meetings, sort of auditing the class before formally registering with the NGFS, and I think that is entirely appropriate.

Senator SCHATZ. Is there a timeframe?

Mr. QUARLES. They have a meeting, their annual general meeting or the equivalent of an annual general meeting, in April, which is when they would be able to address some of these governance issues, if they are able to address them. So I think, you know, it is over that time. But what I would stress is that in the meantime we are engaged with them, involved in attending working groups, *et cetera*.

Senator SCHATZ. The U.K. regulator recently issued guidance that recommends steps that banks take to demonstrate that they are taking climate risks seriously. They are encouraged to assign a senior manager the responsibility for managing climate risks and to demonstrate in writing how the firms' risk management practices address climate risks.

Are you asking banks to do anything similar? And if yes, could you elucidate? If not, why not?

Mr. QUARLES. So we do ask banks that are exposed to severe weather events, which can be generated by climate change, to account for us their risk management practices around that. And as you know, we continue to do a lot of research on the effect of climate change on the financial sector as to how that is likely to evolve, and as we continue to learn from that, we incorporate that into our supervisory practices.

We have also been very closely engaged; I was just in London a couple weeks ago talking with them about how they are looking at climate change regulation and supervision.

Senator SCHATZ. The challenge, I think, for both investors and for firms is that it is not yet apples to apples—right?—in terms of how the disclosures go because everyone is puzzling through it, including the Fed, including the Network for the Greening of the Financial System. And so I think as soon as possible, for the sake of investors having clarity across the market, we are going to need some kind of common instrument to understand, and I think that has got to come from you, because companies, firms, investors are all trying to figure out how to account for climate financial risk, but they are all doing it in unique ways, which makes it super difficult, if you are an investor, to figure out who is accounting for it accurately and how to compare one investment opportunity from the other.

Mr. QUARLES. Yeah, I think that those are very good points. One of the things at the Financial Stability Board that we have done—it was a process that was begun before I began to chair the Financial Stability Board, but that I re-upped when I took over the chairmanship—is this TCFD, which is under the aegis of the Financial Stability Board. Private sector companies are encouraged to think about what climate change risks they may face and then to disclose how they are addressing them if they see them. And we are learning from that. We will be able to learn from that. I think we will be able to take that information and see, OK, well, are there best practices? Is there a common thread that we are beginning to see out of all of this that will be helpful to everyone?

Senator SCHATZ. But you agree that at some point we are going to need a common platform?

Mr. QUARLES. Well, I think that would be useful. You know, at the moment I do not know either what the forum would be or certainly what the content would be of that common platform because, as you note, all of this is in pretty early stages. Even the Bank of England, which is—the Bank of England, I would say, and the Dutch central bank are probably sort of the most committed or have done the most thinking, are farthest along in their thinking about this, and even both of them are really at quite early stages as to concretely how you would address this. And you would need something concrete in order to have a common platform.

Senator SCHATZ. Thank you.

Chairman CRAPO. Senator Cortez Masto.

Senator CORTEZ MASTO. Thank you.

Vice Chairman Quarles, let me start with you, and thank you for visiting with me earlier. We know that the Russian government continues to attack our Nation with a device of inaccurate propaganda in order to weaken Western democracies, and I know just this morning the U.S. and the U.K. law enforcement officials announced charges against two Russians allegedly responsible for what DOJ deemed "two of the worst computer hacking and bank fraud schemes of the past decade." The Treasury Department's Office of Foreign Assets Control announced sanctions against the gang, these two that they dubbed "Evil Corporation"—that is the name that the two have taken on—led by one of the Russians who also provides direct assistance to the Russian government's malicious cyber efforts, highlighting the Russian government's enlistment of cyber criminals for its own malicious purposes.

So I guess my question to you is: If Russia does not stop these attacks on our Nation, should we work with our allies to ban Russian financial institutions from using the SWIFT interbank payment system?

Mr. QUARLES. I would say I have not given any thought to that question, whether that would be an appropriate remedy. In our enforcement practices at the Fed with respect to financial institutions and the abuse of the financial system, we do work closely with the Department of Justice. Frequently Department of Justice actions arise from referrals from us of things that we see with respect to the financial system. So that is something that we are—the issue is something that we are heavily engaged with, but I would be happy to talk with you more about that.

Senator CORTEZ MASTO. I would appreciate that. I know it just broke this morning, so thank you.

Then just for purposes of follow-up on the Chairman's conversation with digital currency, this is also something I am very, very interested in as well. Can you just talk a little bit about what you are doing in this space right now or what you anticipate looking at when it comes to digital currency, if anything?

Mr. QUARLES. So that is at very early stages. I would say that until the recent international focus on stablecoins, there was a general sense among most of the central banks of the advanced financial economies, with isolated exceptions such as Sweden, that digital currencies would not—you know, were not really necessary.

They were not addressing a serious need in those economies. They would be something that might be more rapidly adopted in emerging markets for a variety of reasons, maybe the same way as emerging markets sort of jumped over landlines to cell phones, but that we would—however, since the focus on stablecoins, we have geared up a process to think through the issues. There are a lot of issues, some of the technological, some of them, you know, having to do with monetary policy, some of them having to do with other types of regulatory policy that would have to be worked through, international coordination with respect to it. We are at early stages there in part because up until, I would say, this summer, it was an assessment, and I think the right *ex ante* assessment, that it was not sort of a high priority for the United States, and most advanced financial economies shared that view.

Senator CORTEZ MASTO. OK. But it is something that is obviously—and here is my concern. I appreciate that it is in its initial stages, but I do not think it is something we can assume nothing is going to happen with, and so we at least have to put resources behind it to start looking at and addressing this. And that is what I am hearing you are doing.

Mr. QUARLES. Absolutely.

Senator CORTEZ MASTO. Great.

Mr. QUARLES. Absolutely.

Senator CORTEZ MASTO. Thank you.

Chairwoman McWilliams, studies show that without the Community Reinvestment Act the homeownership rate in our country, and especially for Latinos and African Americans, would be much lower. And I understand the FDIC is considering proposed changes to the Community Reinvestment Act. So how would proposed changes to the CRA close the racial, ethnic homeownership gap? And is that something that is on your radar as you look at making these changes?

Ms. MCWILLIAMS. It is absolutely on my radar as we are looking to make the changes. I think the Act frankly can be revised to do more for those communities, and it can do a whole lot more for rural communities, for small businesses, small farms, family farms, Indian Country. The Act has not been updated since 1995, and all I am asking from folks is to be open-minded when these proposed changes come through, and give us feedback. If there is something that you are concerned about that is not in the proposal, let us know. The intent of the proposal is basically to solicit comment from stakeholders, including Members of Congress and their constituents. The intent here is not to undermine the purpose of the Act and what Congress intended. In fact, the intent, my personal intent, is to strengthen it and make sure that the things that were not existent in 1995 but that do actually help low- and moderate-income and minority communities get enhanced credits under the CRA and are accounted for appropriately. And, you know, Senator Menendez had a line of questions. I was a member of the low- and moderate-income community, and it is not with any malice or bad intent that I would like to take a look at this Act, but more so to make sure that the banks, especially large banks—national banks account for about 70 percent of the CRA activity—are doing their part and doing it in a way that makes sense and clarity for them, but also gets added benefit to those communities.

Senator CORTEZ MASTO. Thank you.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you.

Senator Van Hollen.

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

Vice Chairman Quarles, I know you and I have a difference of opinion on this, but since I have raised it in all the hearings we have had with your colleagues, I do want to say that I fully support the overall decision of the Fed to move forward on a real-time payment system under the FedNow umbrella. And I hope that you will all move with speed on that effort.

Mr. QUARLES. That is the intention, Senator.

Senator VAN HOLLEN. Thank you.

Chair McWilliams, I have some questions related to the issue of rent-a-bank schemes to evade State usury laws. I know this was an issue addressed in the House yesterday and here in this hearing a little bit. I understand that the OCC and FDIC proposed the rule to supposedly provide clarity on this issue in the wake of the Second Circuit decision in *Madden v. Midland.*

My view is that it is probably premature to move forward. I think in the preamble of that rule, you say the FDIC is not aware of any widespread or significant negative effects on credit availability or securitization markets having occurred at this point as a result of the Madden decision. And what I worry about—and I know that your fellow Commissioner Marty Gruenberg shared my concern—is that you have sort of put your foot on the scale in a blunt way, which I think will be interpreted by some to give a green light to some of these schemes.

You stated in the House yesterday that your only purpose was to address a longstanding principle Congress gave that when a loan is made and the interest rates are not usurious at the time the loan was made, that subsequent events do not make those loans usurious, right? But my question is this: Would it be usurious at the time of the loan if the sole purpose of that loan was to evade the interest rates under State laws of the entities' licensing State?

Ms. MCWILLIAMS. It is a great question. The position we have taken at the FDIC under our existing authorities is that we basically determine what is the home State for the bank, and there is a test we go through. This is the issue that I think people are convoluting, the so-called true lender issue versus value-when-made, which are two different, separate legal doctrines.

The proposal we issued literally took what we had pre-Madden and put it on paper and opened it up for public comment, and that is all we did. So this is based on the authorities Congress gave to the FDIC in 1980, gave to the OCC in 1865, and the language I quoted yesterday—probably poorly—on usurious rates is from a Supreme Court case from 1828.

Senator VAN HOLLEN. Here is the issue, if I may. There is a report that one of the—and this problem has gotten worse because we have a lot of nonbank lenders now who are taking advantage of the current system. So a CEO for one of those nonbank lenders said on an earnings call recently, and I quote—he was talking about a California law:

> As you know, in California a piece of legislation would limit the amount of interest that could be charged on loans from $2,500 to $10,000. Similar to our recent experience in Ohio, we expect to be able to continue to serve California consumers via bank sponsors that are not subject to the same proposed State-level rate limitations.

Clearly telling folks on his earnings call that they were going to use this scheme to evade State usury laws.

So my question is: Why not provide guidance in your rule as to what the test is, instead of just sort of sending a green light that is saying, you know, go for it? Because that is the way a lot of people are interpreting it. Why not provide some standard for what you would believe does not constitute a valid loan, a loan that does violate State usury laws?

Ms. MCWILLIAMS. A couple of things on that, and those people who are saying that we gave them a green light, go for it, are mistaken both on legal principle and the regulatory framework we have, including congressional language that was given to us in 1980.

States have an opportunity to opt out under Section 27 of the FDI Act, 27(a) in fact. Congress gave States an opportunity to opt out of the interest rate portability regime. That is, again, not an issue for the FDIC or the issue that we have addressed in this rulemaking.

And the second thing is that we actually specifically said in the preamble to our rule that we look unfavorably upon the so-called rent-a-bank charter, as you referenced it. The purpose here is not to evade the law, and we are not going to allow banks to evade the law.

Senator VAN HOLLEN. But saying you are going to look at something unfavorably without specifying exactly what standard you are going to apply in determining whether it is unfavorable it seems to me creates a green light. That is the concern. You are going to look unfavorably, but you do not clarify what the standard there may be. You know, I understand someone can bring a case and spend a lot of time trying to dig up the evidence, but a rule from all of you would be helpful, it seems to me, in clarifying this.

Mr. Chairman, I have some questions on the CRA, but I will submit them for the record.

Chairman CRAPO. Thank you.

Senator Tester.

Senator TESTER. Thank you, Mr. Chairman. Thanks for holding the hearing, to you and Senator Brown. And I want to thank all of you for being here. I appreciate your work.

I will say leading off that I am disappointed Mr. Otting is not here. I think it is critically important we hear from all the regulators. I have no dog or fight with him. I voted for all you guys, and I voted for him, too, and it would be nice to have him here. I think it is important.

Chairman CRAPO. We will get him here.

Senator TESTER. OK. For the last 18 months, I have heard from bankers that come into my office that, Montana being a State where agriculture is the number one industry, if things do not change with the ag prices at the farm gate, people are going to be in trouble in the next 18 months or at the end of that 18-month period. And we still see ag commodity prices in the tank. We still see these silly trade wars going on that I do not think are going to end up doing anything different than we had to begin with. But that is just a sidebar. That is not your problem.

But what is a problem for us and you is the fact that there are farms right now—and I say this as just a matter of fact—that have been in families for generations and generations and generations. It is more than a job. It is part of who they are as human beings. And they are going to go broke, and the banks are not going to be able to do much about it. But I do want to pose a question to you. What can they do about it? When the prices are down and your collateral goes down because land prices go down with the commodity prices if they stayed down for a period of time, is there anything that the banks can do and still remain viable in times where the prices are at lows—I have been in the business for 42 years. If you want to use inflation-adjusted, they are way, way, way lower than they have ever been. Any ideas? Who wants to be first? And, by the way, Rodney does not have to respond to this because I do not think it is in his bailiwick, but if you want to, you can. Go ahead.

Mr. QUARLES. Obviously, what you are describing is a serious issue. It is one that we do give a lot of thought to at the Federal Reserve. As I think most of you know, I come from the West. I come from an agricultural family. That is something that I think about personally a lot as well.

We have at the Federal Reserve a long history, a lot of experience with the cyclicality of the agricultural economy and the special problems that that raises for agricultural banks. We have examiners that are, you know, specialty focused on those issues. We stand ready to work with banks that are working with their borrowers during periods, so it is a different sort of response than if we had a bank that had a non-agricultural borrower, you know, a different history, a different industry that might be in the same financial position. Just as a matter of risk management, a different response might be appropriate. And so we do have a lot of experience with that. As you have identified, the situation is as bad as it has ever been, and obviously if it goes on long enough, the institution will be required to take the steps that it needs to in order to recover on the loan. But we do not require agricultural banks to do that without any sort of consideration of the circumstances and, again, with a lot of long experience in how to handle that cyclicality.

Senator TESTER. OK. Do you want to comment?

Ms. MCWILLIAMS. I have a couple of things I think I can add to the discussion. We do a quarterly banking profile where we collect call report data from banks on a quarterly basis, and we have seen a modest decline in the agricultural sector, and some of these ag businesses and farmland businesses have gone from net depositors to net borrowers.

Senator TESTER. Right.

Ms. MCWILLIAMS. And as we look at that we looked at what can be done, what can we do, and our examiners were instructed to encourage banks to do workouts in conformance with the safety and soundness standards. But also I think there is an opportunity for us under the existing framework that Congress gave us in the Community Reinvestment Act to do a little bit more, provide more credit for the investments that go to small farms, family farms, rural areas, small businesses, Indian Country. So there is more we can do, I think, frankly, for farmers through the CRA, and that has been one of my instructions to staff as we are considering proposals.

Senator TESTER. Right. So what I am really concerned about here moving forward is just the whole viability of our food system, and family farm agriculture is the basis. You know that. And as we cut bigger checks and farmers become more dependent on the Federal Government—which I do not think any of them want to do, and we can talk about socialism all we want, but that is socialism. And it is just not healthy. You have to deal with the results of poorly thought-out trade wars, but the fact of the matter is, when it comes to losing the farm, it is a big deal.

I have got some questions that I want to give to the record on affordable housing because I think it is one of the biggest barriers we have in this country today, and just there is a lot of stuff going on. But I would love to get your opinion on what we can do to make affordable housing more available across the board, because it is a big issue in urban areas, it is a big issue in rural areas, too.

Senator TESTER. Thank you, Mr. Chairman.

Chairman CRAPO. Thank you. And before we wrap up, Senator Brown has asked to have another 5 minutes for questions.

Senator BROWN. Thank you. And I concur with what Senator Tester said. Housing is everything.

This is a question for Vice Chair Quarles and for Chair McWilliams, if I could. When we were considering the Chairman's bill, S. 2155, to deregulate the largest banks, Federal Reserve Chairman Powell promised the bill did not require getting rid of rules for foreign mega banks. Your agencies then loosened the rules on foreign banks, anyway, including on bad actors like Deutsche Bank, which is by all indications President Trump's ATM.

Did the bill require you to loosen rules—this goes first to you, Ms. McWilliams, then Mr. Quarles. Did the bill require you to loosen the rules for those banks? Yes or on.

Ms. MCWILLIAMS. The FDIC only has backup provisions for the largest banks, including foreign banks.

Senator BROWN. I understand.

Ms. MCWILLIAMS. What I have instructed staff is to look at different capital and liquidity rules that cross-reference sections that are referenced in S. 2155. And to the extent that the agencies rely on, say, the authorities in Section 165, this would be with the Federal Reserve on those rulemakings to tell me if there is an opportunity to amend it and to amend those rules as well.

Senator BROWN. Mr. Quarles, did the bill require you to do that with——

Mr. QUARLES. S. 2155 did not itself instruct or require that we make those adjustments. Other elements of the banking law do require that we take national treatment into account. But in taking it into account, that does not mean that the frameworks will be the same, and they are not identical. There are some material differences between the two frameworks for domestic and foreign banks, although, again, in accordance with the law, we have tried to ensure that it is—you know, that we do take national treatment into account with respect to those frameworks.

Senator BROWN. I think a lot of us were surprised by that action, especially after Chairman Powell said it to a number of us personally and said it to the Committee.

Let me ask a follow-up. One of my Republican colleagues asked about too big to fail. And, again, to the two of you, Ms. McWilliams and Mr. Fall, you had recently relaxed requirements for living wills. Dodd-Frank requires the largest banks to submit living wills that demonstrate they can credibly be resolved under normal bankruptcy procedures without harming the economy.

I will start with you, Mr. Quarles. Do you believe that every bank holding company in the United States, even Bank of America, JPMorgan Chase, Citi, can be resolved in an ordinary bankruptcy without harming the economy?

Mr. QUARLES. I think that the honest answer to that has to be similar to the answer that I gave to Senator Kennedy earlier, which is I believe that there are many more options for the resolution even of the largest institutions than existed before. I think that the work that has been done on resolvability has been useful. I think that it could be possible. They are complex institutions, and the situation in which that issue would arise in the future is difficult to describe precisely, and so I would not want to say that you would always be able to do it. But I think we are closer to being able to do it, much closer than we were before.

Senator BROWN. Ms. McWilliams?

Ms. MCWILLIAMS. So bankruptcy is the preferred route. Actually, it is a statutory mandate as well. We have to consider bankruptcy first. Congress gave the FDIC additional authorities in Title II of Dodd-Frank through the Orderly Liquidation Authority, and a fund I never hope to use and I never want to use, the Orderly Liquidation Fund, to resolve these large banks. But, generally, bankruptcy would be our preferred route, and we have engaged a number of bankruptcy judges in understanding exactly how that would be done and could be done for some of these large entities.

Senator BROWN. Thank you both. The point of the law a decade ago was to make giant banks simpler and smaller so they could go through an orderly bankruptcy. The point was not to make bankruptcy more complicated or special for mega banks. We are seeing not only the biggest banks, even bigger than before the crisis, your agencies just approved another big merger. The merger creates a bank twice as large as Washington Mutual was at that time when it caused the biggest loss to the Deposit Insurance Fund in history, and I think we need to be cautious.

One last statement, Mr. Chairman. I heard the comment earlier about the most—your 35 years of experience, Mr. Quarles, and the banking system is, you said, bigger, stronger, more stable. It is certainly more profitable, but the more profitable should not be the measure of any of our work. The measure should be the safety and soundness of the financial system with all that that means. And as you continue to move toward less regulation, it is hard to believe it is making it stronger. It seems to me your agencies are making the market less competitive by weakening rules for the largest banks, allowing them to make risky leveraged bets rather than requiring them to provide banking services in the places where it is needed most, and weakening and gutting regulations, you claim to be making the economy work better for small businesses and farmers and workers and small banks, but your actions pave the way for mega banks and Wall Street to make the same risky bets that shut our businesses and banks, and those action I think betray this economy.

Thank you, Mr. Chairman.

Chairman CRAPO. Thank you, Senator Brown, and I again appreciate our witnesses and the attention that you have brought to these issues here today. And as I said at the outset, I appreciate the work you have been doing to effectively implement Senate bill 2155 and also basically frame our regulatory approach in the ways that best strengthen our economy, strengthen our opportunities for strong housing and for jobs and benefits and growth in our economy. And I look forward to the next time we have an opportunity to bring you before us.

Again, thank you for being here. This hearing is adjourned.

[Whereupon, at 11:34 a.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF CHAIRMAN MIKE CRAPO

Today we will receive testimony from: the Honorable Randal Quarles, Federal Reserve Vice Chairman for Supervision; the Honorable Jelena McWilliams, Chairman of the FDIC; and the Honorable Rodney Hood, Chairman of the NCUA.

This hearing provides the Committee an opportunity to examine the current state of and recent activities related to the regulatory and supervisory activities of these agencies.

It has been over a year now since the enactment of S. 2155, the Economic Growth, Regulatory Relief and Consumer Protection Act, and the work of the agencies to implement most of the law's provisions, including the tailoring rules for U.S. banks and U.S. operations of foreign banks.

Your agencies should also carefully review the existing supervisory frameworks and make any necessary adjustments to appropriately align them with the tailoring rules and requirements.

On July 30, 2019, all of the Republican Banking Committee Members and I sent a letter to the Federal banking regulators urging your agencies to finalize several outstanding provisions of S. 2155, such as the Community Bank Leverage Ratio and short-form call reports, and to further tailor regulations to promote economic growth, including addressing the Current Expected Credit Losses accounting standard, the Volcker Rule, inter-affiliate margin and Madden.

Thank you for acting on many of these priorities. I encourage you to continue exploring additional opportunities to tailor rules.

In that July letter, as well as an October 2018 letter to your agencies, several Banking Committee Republicans and I urged your agencies to revise the Volcker Rule, including using your discretion granted by Congress to address the current covered funds overly broad definition.

Although your agencies joined the SEC and CFTC to issue a proposal revising several aspects of the Volcker Rule, the 'covered funds' provision was left relatively untouched.

I encourage your agencies to take quick action to address the "covered funds" issue by revising the definition's overly broad application to venture capital, other long-term investments and loan creation.

Separately, in September, short-term borrowing rates spiked as a result of a large corporate tax payment coming due, and $300 billion in Treasuries hitting the market, even in light of banks holding a surplus of cash at the Fed, currently around $1.4 trillion.

In light of these events, banks could have stepped in to alleviate the volatility in those markets by lending some of the excess cash that they hold at the Fed. So, why did they not do that?

Some have suggested that certain aspects of the Fed's supervision and regulations imposed after the 2008 financial crisis may have exacerbated this problem, specifically the treatment of cash versus treasuries.

Although the Fed has taken some steps to address the issue in the short-term by buying Treasuries and lending funds, it is important that the Fed review the details of its current regulatory and supervisory regime for potential long-term fixes.

Now quickly turning to guidance, Senators Tillis, Perdue, Rounds, Cramer and I wrote to GAO in February asking for its legal opinion as to whether three Federal Reserve Supervision and Regulation Letters constitute a rule under the congressional Review Act (CRA).

In its October response, GAO concluded that two of the letters, including one providing a new supervision framework for large financial institutions and another related to recovery planning, are rules under the CRA, and are required to be submitted to Congress for review.

During the Banking Committee's April hearing on this very issue, I urged your agencies to follow the CRA and submit all rules to Congress, even if they have not gone through a formal notice-and-comment rulemaking to continue providing more clarity about the applicability of guidance.

I encourage the Federal banking regulators to take a more deliberate approach going forward, and take any necessary steps to rectify informal guidance that has not been submitted to Congress.

In January 2019, the NCUA announced the portion of regulations that would be reviewed as a part of the process through which the agency reexamines all of its existing regulations every 3 years.

The comment period for that review process has since closed, and I look forward to learning more about the regulatory recommendations provided to the NCUA and its roadmap for actions going forward.

Finally, the Banking Committee has been exploring digital currencies over the last few Congresses, especially in light of the recent development of the Libra digital currency, started by Facebook.

In July, I asked Federal Reserve Chairman Powell about his understanding of and the Fed's role in the project.

Although Chairman Powell noted that the Fed has set up a working group to focus on Libra and is in contact with the other regulatory agencies, he also said that "There is not any one agency that can stand up and have oversight over this."

Given its scope, regulators across the globe continue to evaluate Libra, its potential impact in the marketplace, and consider appropriate and necessary regulatory responses.

It seems that digital currencies are inevitable, and the United States needs to lead by providing clear rules of the road.

During this hearing, I look forward to learning more about the status of addressing the overly broad covered funds definitions in the Volcker Rule, especially with respect to long-term investments; how the agencies are thinking through the recent turmoil in the repo market, and what adjustments may be appropriate for a long-term fix; whether the supervisory framework that applies to banks currently needs to be updated to better reflect changes made in the tailoring rules; and how the agencies are thinking about the Libra project, including what U.S. regulatory framework merits consideration to balance innovation and protect its users and privacy.

I thank each of you for your willingness to join the Committee today to discuss your agencies' regulatory and supervisory activities, and these important issues.

PREPARED STATEMENT OF SENATOR SHERROD BROWN

Thank you, Mr. Chairman. I want to start by noting that typically when we have the financial regulators testify, the Comptroller of the Currency is also here. Mr. Otting had a conflict today. He is expected to announce changes to the Community Reinvestment Act shortly, changes that the civil rights community and others are very concerned about. I share those concerns, and I expect that we will have him up before this Committee to talk about this proposal and other activities at the OCC soon.

We all saw how Wall Street's financial schemes hurt regular people when they blow up in bankers' faces, like they did in 2008.

You all saw the devastation of the crisis. Whether as a staffer in the Senate, while serving at the agency you now lead, or at a private equity firm after a stint at Treasury—you had a front row seat.

That's why I'm concerned about the collective amnesia you all appear to have as you make changes to the bank rules—changes that allow Wall Street to get back to its old tricks, and that I fear will cost Americans their jobs, homes, and savings the next time complicated bets blow up in bankers' faces.

But what is sometimes harder to see are the schemes that hurt families and the economy even when they work exactly how Wall Street intends.

Unfortunately, Ohio is the setting of one of these Wall Street schemes. Twelve years ago, just before the financial crisis, a giant private equity firm bought a nursing home company based in Toledo that operated facilities nationwide.

Soon that nursing home company was being strangled by debt from risky leveraged loans. It laid off hundreds of staff and let its patients suffer under negligent, horrifying conditions.

According to the Washington Post, staffing cuts meant there weren't enough nurses to respond to patients.

Health code violations rose dramatically.

In Pennsylvania, a patient broke her hip and crashed to the floor when a staffer tried to do a two-person job and move her on his own.

Patients faced other living conditions that no human should have to endure, waiting in soiled clothing and dirty beds for help that was never going to come.

And all the while, that Wall Street private equity firm was extracting more profits.

Last year, the nursing home company went bankrupt. But that didn't stop the private equity firm from making huge profits on their investment.

This is what happens when leveraged loans, collateralized loan obligations, and leveraged buyouts work as designed. Wall Street extracts all the profits out of the company, and the rest of us—workers, patients, our families—we pay for it.

Today Wall Street is looking for profits anywhere it can find them, and these schemes squeeze money out of every part of the economy—from hospitals in Philadelphia, Pennsylvania, and Massillon, Ohio, to manufactured home communities in

Iowa and New Hampshire—not just harming individual families, but entire communities.

Imagine how bad it will be if these complex financial transactions blow up like the subprime mortgage ones did in 2008.

This is just one of so many challenges working families are facing.

We got a report this week showing that almost half of all American workers are stuck in low-wage jobs. One-in-four families spend more than half of their income on rent and utilities. Forty percent of Americans are so short on cash they would be forced to borrow money to cover a $400 expense.

More and more families have to borrow just to get by—credit card debt, student loan debt, and mortgage debt—are all higher than before the crisis. Wall Street squeezes more out of every paycheck, adding to their billions.

If regular Americans are struggling 10 years into a so-called recovery—when the stock market is booming—what will happen in a recession?

This can't be how the financial system should work.

The regulators' job isn't to protect profits for big banks and big corporations. It's to protect our economy and our financial system, and the ordinary families that the system is supposed to serve.

I guess when the President says "draining the swamp," he really means betraying workers and giving Wall Street free rein to prey on them and wring every last cent out of profit of our communities.

This President uses his phony populism—racism, antisemitism, anti-immigrant slander—to divide us, to distract from all the ways he and his hand-picked cronies have betrayed working families and left them struggling.

That's not how a democracy should function, and I am deeply worried that if you don't stand up for workers and families, so much in our economy and our democracy is at risk.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF RANDAL K. QUARLES

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

DECEMBER 5, 2019

Chairman Crapo, Ranking Member Brown, Members of the Committee, thank you for the opportunity to appear today, alongside my colleagues from the regulatory community. We join you on the cusp of a significant and shared milestone: the full and faithful implementation of Congress's efforts to improve financial regulation, in the form of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).[1] Today, I will briefly review the steps we have taken toward this milestone; share information on the state of the banking system, from the report that accompanies my testimony; and discuss the continuing need to ensure our regulatory framework is both coherent and effective.[2]

Roughly 18 months ago, Congress passed legislation to consolidate a decade of work on financial reform, and to better tailor financial regulation and supervision to the risks of the institutions being regulated. The EGRRCPA was a specific, targeted response to the conditions facing today's banking organizations and their customers. It was also rooted, however, in longstanding congressional practice: of reviewing the work done in the immediate aftermath of a crisis; of addressing any gaps; and of ensuring that public and private resources go toward their best, most efficient use. This approach informed the Banking Acts of 1933 and 1935, on issues from shareholder liability to deposit insurance.[3] It informed the bills passed after the savings-and-loan crisis, requiring "prompt corrective action" at struggling firms and reducing the examination burden at strong ones.[4] And it continues to inform

[1] EGRRCPA, Pub. L. No. 115–174, 132 Stat. 1296 (2018).

[2] Board of Governors of the Federal Reserve System, "Supervision and Regulation Report," November 26, 2019, *https://www.federalreserve.gov/publications/files/201911-supervision-and-regulation-report.pdf*.

[3] *See* Gary Richardson, Alejandro Komai, and Michael Gou, "Banking Act of 1935," Federal Reserve History (website), Federal Reserve Bank of Richmond, November 22, 2013, *https://www.federalreservehistory.org/essays/banking-act-of-1935*.

[4] *See* Noelle Richards, "Federal Deposit Insurance Corporation Improvement Act of 1991," Federal Reserve History (website), Federal Reserve Bank of Richmond, November 22, 2013, *https://www.federalreservehistory.org/essays/fdicia*.

our efforts now, from the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act to today.[5]

The Board's latest *Supervision and Regulation Report,* which we published last week, confirms the current health of the banking system.

- It depicts a stable, healthy, and resilient banking sector, with robust capital and liquidity positions.
- It details stable loan performance and strong loan growth, particularly among regional banks, whose share of overall bank lending continues to grow.
- It describes steady improvements in safety and soundness, with a gradual decline in outstanding supervisory actions at both the largest and smallest organizations.
- And it identifies areas of continued supervisory focus, including operational resiliency and cyber-related risks, which are among our top priorities for the year to come.

The banking system is substantially better prepared to manage unexpected shocks today than it was before the financial crisis. Now, when the waters are relatively calm, is the right time to step back and examine the efficiency and effectiveness of our protection against future storms. With the EGRRCPA, Congress made a significant down payment on that task. In less than 18 months after the Act's passage, we implemented all of its major provisions.

Earlier this year, we completed a cornerstone of the legislation to tailor our rules for regional banks, which was entirely consistent with a principle at the heart of our existing work: firms that pose greater risks should meet higher standards and receive more scrutiny. Our previous framework relied heavily on a firm's total assets as a proxy for these risks and for the costs the financial system would incur if a firm failed. This simple asset proxy was clear and critical, rough and ready, but neither risk-sensitive nor complete. Our new rules employ a broader set of indicators, like short-term wholesale funding and off-balance-sheet exposures, to assess the need for greater supervisory scrutiny.[6] They maintain the most stringent requirements and strictest oversight for the largest, most complex organizations—the collapse of which would do the most harm.

We and our interagency colleagues also have worked on a range of measures addressed to smaller banks, with particular attention to better capturing and reflecting the characteristics of the community bank business model. These include elements of last year's legislation, and other steps we have taken in the same spirit, intended to help community banking organizations survive and thrive:

- We adjusted the scope of our supervisory assessments, our stress-testing requirements, our appraisal regulations, and the Volcker rule—all aimed at the activities of large, complex institutions, not small local banks.[7]
- We clarified our capital treatment of commercial real estate loans, which are central to the credit books of many community banks.

[5] Dodd-Frank Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

[6] Board of Governors of the Federal Reserve System, "Federal Reserve Board Finalizes Rules That Tailor Its Regulations for Domestic and Foreign Banks to More Closely Match Their Risk Profiles; news release, October 10, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm.*

[7] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies Issue Final Rule to Exempt Residential Real Estate Transactions of $400,000 or Less from Appraisal Requirements," news release, September 27, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190927a.htm;* Board of Governors of the Federal Reserve System, Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Securities and Exchange Commission, "Agencies Finalize Changes to Simplify Volcker Rule," news release, October 8, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191008a.htm;* Board of Governors of the Federal Reserve System, "Federal Reserve Board Finalizes Rules That Tailor Its Regulations for Domestic and Foreign Banks to More Closely Match Their Risk Profiles," news release, October 10, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm;* Board of Governors of the Federal Reserve System, "Federal Reserve Board Invites Public Comment on Proposal That Would Modify Company-Run Stress Testing Requirements to Conform with Economic Growth, Regulatory Relief, and Consumer Protection Act,"news release, January 8, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190108a.htm;* and Board of Governors of the Federal Reserve System, "Federal Reserve Board Issues Statement Describing How, Consistent with Recently Enacted EGRRCPA, the Board Will No Longer Subject Primarily Smaller, Less Complex Banking Organizations to Certain Board Regulations," news release, July 6, 2018, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180706b.htm.*

- We detailed our approach to anti-money-laundering exams, and our goal of prioritizing high-risk activities over routine matters.[8]
- We expanded eligibility for our small bank holding company policy statement, opening the door to simpler funding requirements for a broader range of small banking firms.[9] We also increased the scope of banks eligible for longer examination cycles.[10]
- We revised a management-interlock rule for the first time since 1996, removing a governance barrier for more small banks and their holding companies.[11]
- We made our short-form call report shorter, removing items that were often ancillary to filers' core lending activities.
- And we finalized a new community bank leverage ratio, giving small, strong banking organizations a much simpler way to meet their capital requirements.[12]

Our goal, through this period of intense regulatory activity, has been to faithfully implement Congress's instructions. However, those instructions also speak to a broader need, and one central to our ongoing work: to ensure our regulatory regime is not only simple, efficient, and transparent, but also coherent and effective.[13]

Financial regulation, like any area of policy, is a product of history. Each component dates from a particular time and place, and it was designed, debated, and enacted to address a particular set of needs. No rule can be truly evergreen; gaps and areas for improvement will always reveal themselves over time. Our responsibility—among the most challenging and essential we have—is to address those gaps without creating new ones; to understand fully the interaction among regulations; to reduce complexity where possible, before it becomes its own source of risk; and to ensure our *entire* rulebook supports the safety, stability, and strength of the financial system.

Looking ahead, my colleagues and I are paying particular attention to coherence in our capital regime. We are reviewing public input into proposed changes to the stress capital buffer, which would simplify our regime by integrating our stress-test and point-in-time capital requirements and maintain our current strong levels of capital.[14] As we move forward, we also understand the need to thoughtfully finalize implementation of Basel III, in a way that preserves aggregate capital and liquidity

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[8] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies Propose Rule Regarding the Treatment of High Volatility Commercial Real Estate," news release, September 18, 2018, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180918a.htm;* and Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Financial Crimes Enforcement Network, National Credit Union Administration, and Office of the Comptroller of the Currency, "Federal Bank Regulatory Agencies and FinCEN Improve Transparency of Risk-Focused BSA/AML Supervision," news release, July 22, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190722a.htm.*

[9] Board of Governors of the Federal Reserve System, "Federal Reserve Board Issues Interim Final Rule Expanding the Applicability of the Board's Small Bank Holding Company Policy Statement," news release, August 28, 2018, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180828a.htm.*

[10] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies Issue Final Rules Expanding Examination Cycles for Qualifying Small Banks and U.S. Branches and Agencies of Foreign Banks," news release, December 21, 2018, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20181221c.htm.*

[11] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies Issue Final Rule to Update Management Interlock Rules," news release, October 2, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191002a.htm.*

[12] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Federal Bank Regulatory Agencies Issue Final Rule to Simplify Capital Calculation for Community Banks," news release, October 29, 2019, *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191029a.htm.*

[13] Randal K. Quarles, "Early Observations on Improving the Effectiveness of Post-Crisis Regulation" (speech at the American Bar Association Banking Law Committee Annual Meeting, Washington, DC, January 19, 2018), *https://www.federalreserve.gov/newsevents/speech/quarles20180119a.htm.*

[14] Randal K. Quarles, "Refining the Stress Capital Buffer" (speech at the Program on International Financial Systems Conference, Frankfurt, Germany, September 5, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles20190905a.htm;* and Randal K. Quarles, "Stress Testing: A Decade of Continuity and Change" (speech at the "Stress Testing: A Discussion and Review" research conference sponsored by the Federal Reserve Bank of Boston, July 9, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles20190709a.htm.*

levels at large banking organizations, avoids additional burden at smaller ones, and upholds our standards for transparency and due process.

We also understand the need to ensure a smooth transition away from LIBOR, and other legacy benchmark rates, so institutions can manage risks comprehensively and effectively.[15] And we understand the need for clear, consistent supervisory communication on these and other matters, which invites dialogue, reflects and reinforces our regulations and laws, and gives banks necessary transparency into supervisory views on safety and soundness.[16]

We also understand the need to thoughtfully address new financial products and technologies. Innovation has the potential to improve access to financial services, lower costs, and support the competitive health of the banking sector. Its promise, however, inevitably comes with risk—and as the financial crisis showed, risks that lie outside the banking system can have consequences within it. Our approach to innovation should be both open and careful, engaging thoughtfully with both the public and private sectors, to understand the benefits and costs that such fundamental changes can bring.

Finally, we understand the need for coherence across borders. Over the last decade, working with supervisors around the world, we have built a common understanding of the crisis, its causes, and its consequences. Now, as the full set of post-crisis reforms comes into effect, we should renew our focus on assessing their implementation and their overall impact. The financial system is truly global, and the structures and incentives that govern it are critical to its stability and resilience.[17] The regulatory community has started significant work to examine those structures and incentives as a whole, from their effect on "too-big-to-fail" subsidies to their impact on market fragmentation.[18] We are participating actively in that work, as a way to ensure the global financial system supports, rather than inhibits, American growth.

I appreciate the chance to discuss this work with you, and I look forward to answering your questions. Thank you.

PREPARED STATEMENT OF JELENA MCWILLIAMS

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

DECEMBER 5, 2019

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

Exactly 18 months ago, I began serving as the 21st Chairman of the Federal Deposit Insurance Corporation (FDIC). During this period, the FDIC has undertaken a significant amount of work with a particular emphasis on three overarching goals:

- Strengthening the banking system as it continues to evolve;
- Ensuring that FDIC-supervised institutions can meet the needs of consumers and businesses; and
- Fostering technology solutions and encouraging innovation at community banks and the FDIC.

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[15] Randal K. Quarles, "The Next Stage in the LIBOR Transition" (speech at the Alternative Reference Rates Committee Roundtable, cohosted by the Alternative Reference Rates Committee and the New York University Stern School of Business and Its Salomon Center for the Study of Financial Institutions, New York, June 3, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles20190603a.htm.*

[16] Randal K. Quarles, "Law and Macroeconomics: The Global Evolution of Macroprudential Regulation" (speech at the "Law and Macroeconomics" conference at Georgetown University Law Center, Washington, DC, September 27, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles20190927a.htm.*

[17] Randal K. Quarles, "Government of Union: Achieving Certainty in Cross-Border Finance" (speech at the Financial Stability Board Workshop on Pre-Positioning, Ring-Fencing, and Market Fragmentation, Philadelphia, September 26, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles201909?6a.htm.*

[18] Randal K. Quarles, "The Financial Stability Board at 10 Years—Looking Back and Looking Ahead" (speech at the European Banking Federation's European Banking Summit, Brussels, Belgium, October 3, 2019), *https://www.federalreserve.gov/newsevents/speech/quarles2019 1003a.htm;* see also, Financial Stability Board, "FSB Launches Evaluation of Too-Big-to-Fail Reforms and Invites Feedback from Stakeholders," news release, May 23, 2019, *https://www.fsb.org/2019/05/fsb-launches-evaluation-of-too-big-to-fail-reforms-and-invites-feedback-from-stakeholders/;* and Financial Stability Board, "FSB Publishes Report on Market Fragmentation," news release, June 4, 2019, *https://www.fsb.org/2019/06/fsb-publishes-report-on-market-fragmentation/.*

The FDIC has made significant progress in each of these areas, and I appreciate the opportunity to share with the Committee how we will continue to move each of them forward.

I. State of the U.S. Banking Industry

Before discussing the FDIC's work to strengthen the banking system, I would like to begin by providing context regarding the current state of the industry.

The U.S. banking industry has enjoyed an extended period of positive economic growth. In July, the economic expansion became the longest on record in the United States. By nearly every metric—net income, net interest margin, net operating revenue, loan growth, asset quality, loan loss reserves, capital levels, and the number of "problem banks"—the banking industry is strong and well-positioned to continue supporting the U.S. economy.

With respect to profitability, banks of all sizes are performing well. In the third quarter of 2019, the 5,256 FDIC-insured banks and savings institutions reported net income of $57.4 billion.[1] Nearly 62 percent of institutions reported annual increases in net income, and only about 4 percent of institutions were unprofitable. Notably, community banks reported net income of $6.9 billion, an increase of 7.2 percent from a year earlier. Net interest margin also remained stable, with an average of 3.35 percent across the industry and a particularly strong average of 3.69 percent among community banks. Finally, net operating revenue totaled over $208 billion, an increase of 2.2 percent from a year earlier.

Key balance sheet indicators are similarly robust. Total loan balances increased by 4.6 percent, up from the 4.5 percent growth rate reported the previous quarter. Again, community banks performed particularly well in this area, with an annual rate of loan growth that was stronger than the overall industry. Asset quality also remained strong, as the rate of noncurrent loans (*i.e.,* loans that are 90 days or more past due) declined to 0.92 percent. Finally, the industry's capacity to absorb credit losses improved from a year earlier, as the reserve coverage ratio (*i.e.,* loan-loss reserves relative to total noncurrent loan balances) rose to 131 percent.

Although the current interest rate environment may result in new challenges for banks in lending and funding, the industry is well-positioned to remain resilient throughout the economic cycle, principally as a result of greater and higher-quality equity capital. Equity capital across the industry rose to $2.1 trillion, up $3.5 billion from the previous quarter. This capital increase translated to an aggregate common equity tier 1 capital ratio of 13.25 percent.

The number of institutions on the FDIC's "Problem Bank List" declined from 56 to 55, the lowest number since the first quarter of 2007, and four new banks opened during the third quarter for a total of 10 new banks in 2019.

Four banks failed during 2019—the first failures since December 2017. It is important to recognize that, even in a healthy economy, some banks will inevitably fail. The economic expansion we have experienced resulted in an anomalous stretch in which there were zero bank failures. This expansion and consequent absence of failures cannot endure forever. It is normal—and indeed expected—for some banks to fail, and our job at the FDIC is to protect depositors and ensure that banks can fail in an orderly manner.

The key to the FDIC's ability to protect depositors is the administration of the Deposit Insurance Fund (DIF), which increased to a record $108.9 billion in the third quarter.[2] The DIF's reserve ratio (*i.e.,* the fund balance as a percent of estimated insured deposits) increased to 1.41 percent, the highest level since 1999.

In 2010, Congress instituted the DIF Restoration Plan, which required the FDIC to raise the DIF minimum reserve ratio from 1.15 percent to 1.35 percent by September 30, 2020. Although we continue to work toward our 2 percent target, the FDIC has met the statutory requirement and formally exited the DIF Restoration Plan. Accordingly, we have awarded $764.4 million in credits to banks with less than $10 billion in assets for the portion of their assessments that contributed to the increase.[3]

In addition, the FDIC recently proposed a rule[4] that would amend our deposit insurance assessment regulations to continue to apply small bank credits as long as the DIF remains at least 1.35 percent rather than the current 1.38 percent. This

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[1] *See* FDIC Quarterly Banking Profile, Third Quarter 2019, available at *https://www.fdic.gov/bank/analytical/qbp/2019sep/qbp.pdf.* Unless otherwise indicated, all statistics are derived from this report as of the third quarter of 2019.

[2] *See* FDIC Deposit Insurance Fund Trends, Third Quarter 2019, available at *https://www.fdic.gov/bank/analytical/qbp/2019sep/qbpdep.html.*

[3] *Id.*

[4] *See* Assessments, 84 Fed. Reg. 45443 (Aug. 29, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-08-29/pdf/2019-18257.pdf.*

proposal seeks to make the application of small bank credits to quarterly assessments more stable and predictable for smaller institutions and simplify the FDIC's administration of these credits without impairing our ability to maintain the required minimum reserve ratio of 1.35 percent.

The FDIC will continue to manage the DIF prudently and responsibly in pursuit of our statutory mission to maintain stability and public confidence in the Nation's financial system.

II. Strengthening the Banking System

While the state of the banking system remains strong, the FDIC is not standing idly by. We continue to monitor changes in the industry and work to further strengthen the banking system by:

- Modernizing our approach to supervision and increasing transparency;
- Tailoring regulations;
- Enhancing resolution preparedness;
- Assessing new and emerging risks; and
- Creating the workforce of the future.

I will address each of these efforts in turn.

A. Modernizing Supervision and Increasing Transparency

As the primary supervisor of the majority of the Nation's small and medium-size banks, the FDIC oversees a segment of the banking system that plays a vital role in communities across the country.[5] Through our back-up examination authority, the FDIC also has the ability to examine the Nation's largest banks.

Having worked both as a regulator and at a regulated entity before arriving at the FDIC, I have spent a great deal of time thinking about effective supervision and examination. Our supervisory approach should achieve the following objectives: (1) ensure that institutions are safe and sound; (2) provide clear rules of the road; (3) be consistent in its application; (4) be fair, effective, and holistic in the consideration of regulatory issues; (5) be timely and contemporary in providing feedback; (6) respect the business judgment of an institution's management team; and (7) promote an open, two-way dialogue between the regulated and the regulators.

In furtherance of these objectives, the FDIC has undertaken a number of reforms to modernize our approach to supervision and increase the transparency of our programs.

1. CAMELS Ratings

The FDIC and the Federal Reserve Board (FRB) recently issued a notice and request for comment on the consistency of ratings assigned under the Uniform Financial Institutions Rating System (UFIRS), commonly known as CAMELS ratings because of the six evaluation components (*i.e.,* Capital, Asset Quality, Management, Earnings, Liquidity, and Sensitivity to Market Risk).[6] This system, which was established in 1979, is critical to our supervisory efforts. Despite vast changes in technology, industry practices, and regulatory standards, the system has not been materially updated in nearly 25 years. We are seeking feedback on how CAMELS ratings are assigned to supervised institutions and the implications of such ratings in the application and enforcement action processes. This request is consistent with our commitment to increase transparency, improve efficiency, support innovation, and provide opportunities for public feedback. We look forward to receiving public comments and engaging further with stakeholders and the other banking agencies on this effort.

2. "Trust through Transparency"

With the goal of increasing the transparency of our supervisory programs, my first major initiative as Chairman was "Trust through Transparency," which builds upon the agency's solid foundation of public trust and accountability by fostering a deeper culture of openness. As part of this initiative, we launched a new public section of our website where we publish FDIC performance metrics, including turnaround

[5] As of September 30, 2019, the FDIC insures the deposits of 5,256 institutions and acts as the primary supervisor of 3,384 State-chartered institutions that are not members of the Federal Reserve System.

[6] *See* Request for Information on Application of the Uniform Financial Institutions Rating System, 84 Fed. Reg. 58383 (Oct. 31, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-10-31/pdf/2019-23739.pdf.*

times for examinations and bank charter applications, call center usage and response times, and data on the status of supervisory and assessment appeals.[7]

This program is not *just* about publishing more information. Instead, we are using the heightened public scrutiny of our work to hold ourselves publicly accountable to high standards, and our effort is already yielding positive results.

3. Supervision Modernization

As part of our efforts to modernize supervision, FDIC examination teams are leveraging technology to reduce the amount of time they spend onsite at supervised institutions. This reduces the compliance burden for institutions—especially community banks—without sacrificing the quality of our supervision.

As a result, our examination turnaround time (*i.e.,* the time from when field work begins to when the examination report is sent to the bank) has significantly improved. During the 12 months ended September 30, 2019, more than 87 percent of safety and soundness examinations were conducted within our 75-day goal and more than 96 percent of consumer compliance and Community Reinvestment Act (CRA) examinations were conducted within our 120-day goal. Similarly, examination report processing time (*i.e.,* the time from when field work is complete to when the report is sent to the bank) has improved, with more than 92 percent of safety and soundness reports and more than 98 percent of consumer compliance and CRA reports processed within our 45-day goal.

We recently established a new Subcommittee on Supervision Modernization—which reports to our Community Bank Advisory Committee (CBAC)—to make recommendations for improving our supervisory activities. The Subcommittee, which is comprised of 15 bankers, technologists, former regulators, and legal experts, is tasked with considering how the FDIC can further leverage technology and refine its processes to improve the efficiency of the examination program, while managing and training a geographically dispersed workforce.

4. *De Novo* Application Process

Another key focus of our supervisory modernization effort has been the *de novo* application process. *De novo* banks are an important source of new capital, talent, and ideas, and many offer products and services to underserved communities and fill gaps in overlooked markets. The need for these institutions is underscored by the uneven distribution of banking offices across the country. As of June 30, 2019, 620 counties—or 20 percent of the counties across the Nation—were served only by community banking offices, 127 counties had only one banking office, and 33 counties had no banking offices at all.[8]

In the decade immediately following the financial crisis, very few new banks opened due to the challenging economic environment and regulatory constraints. During my first year as Chairman, the FDIC emphasized the need for greater *de novo* activity, and the FDIC has taken several actions to support this objective, including:

- Revising our process for reviewing deposit insurance proposals to provide initial feedback to organizers on draft applications prior to submission;[9]
- Updating two manuals related to the deposit insurance application process;[10]
- Issuing a request for information to solicit additional ideas for improvement;[11] and
- Engaging with stakeholders at seven roundtables across the country.

Results we have seen thus far are encouraging. Organizers have expressed renewed interest in *de novo* charters, and we approved 14 *de novo* banks in 2018—more than the total number of approvals in the eight previous years combined.[12]

[7] *See* FDIC Transparency & Accountability, available at *https://www.fdic.gov/transparency.*

[8] *See* FDIC Summary of Deposits, available at *https://www7.fdic.gov/SOD.*

[9] *See* FDIC FIL–82–2018, Review Process for Draft Deposit Insurance Proposals (Dec. 6, 2018), available at *https://www.fdic.gov/news/news/financial/2018/fil18082.html.*

[10] *See* FDIC FIL–83–2018, FDIC Issues an Update to its Publication Entitled Applying for Deposit Insurance—A Handbook for Organizers of *De Novo* Institutions, Finalizes its Deposit Insurance Applications Procedures Manual, and Establishes a Designated Applications Mailbox (Dec. 6, 2018), available at *https://www.fdic.gov/news/news/financial/2018/fil18083.html.*

[11] *See* Request for Information on the FDIC's Deposit Insurance Application Process, 83 Fed. Reg. 63868 (Dec. 12, 2018), available at *https://www.govinfo.gov/content/pkg/FR-2018-12-12/pdf/2018-26811.pdf.*

[12] *See* FDIC Decisions on Bank Applications, available at *https://www.fdic.gov/regulations/laws/bankdecisions/depins/index.html.*

This momentum has continued throughout 2019, and we have approved eight *de novo* banks thus far.

5. Interagency Statement on Alternative Data

Earlier this week, the FDIC, FRB, Office of the Comptroller of the Currency (OCC), Consumer Financial Protection Bureau (CFPB), and National Credit Union Administration (NCUA) jointly issued a statement [13] encouraging the responsible use of alternative data (*i.e.,* data not typically found in the consumer's credit files of the nationwide consumer reporting agencies or customarily provided as part of applications for credit) for use in credit underwriting.

The agencies recognize that the use of alternative data may improve the speed and accuracy of credit decisions and may help firms evaluate the creditworthiness of consumers who currently may not obtain credit in the mainstream credit system. The statement also emphasizes that, if firms choose to use alternative data, they must comply with applicable consumer protection laws, including fair lending laws and the Fair Credit Reporting Act.

6. Federal Interest Rate Authority

Our push for modernization is not limited to supervision and examination programs, but also includes work to provide clarity on key legal issues. One specific example of this approach is an ongoing effort to address marketplace uncertainty regarding the enforceability of the interest rate terms of loan agreements following a bank's assignment of a loan to a nonbank. In 2015, the United States Court of Appeals for the Second Circuit issued a decision [14] that called into question such enforceability by holding that 12 U.S.C. § 85—which authorizes national banks to charge interest at the rate permitted by the law of the State in which the bank is located, regardless of other States' interest rate restrictions—does not apply following assignment of a loan to a nonbank. Although this decision concerned a loan made by a national bank, the statutory provision governing State banks' authority with respect to interest rates is patterned after and interpreted in the same manner.[15]

Last month, we proposed a rule [16] that would clarify the law governing the interest rates State banks may charge. Among other things, the proposal would provide that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act (FDI Act) would be determined at the time the loan is made, and interest on a loan permissible under section 27 would not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

7. Cooperation with State Regulators

In an effort to facilitate and increase dialogue between the FDIC and our State regulatory partners on a host of important regulatory issues, the FDIC approved the establishment of a new Advisory Committee of State Regulators (ACSR).[17] The committee will allow the FDIC and State regulators to discuss a variety of current and emerging issues that have potential implications for the regulation and supervision of State-chartered financial institutions. Once fully established, ACSR will facilitate discussions of: safety and soundness and consumer protection issues; the creation of new banks; the protection of our Nation's financial system from risks such as cyberattacks or money laundering; and other timely issues.

B. Tailoring Regulations

As we continue to think about ways to strengthen the banking system, the appropriate calibration of our regulatory framework remains a top priority. Given the wide range of risk profiles across banking organizations, it is critical that regulators continuously evaluate whether our rules are being applied properly and not imposing unnecessary regulatory burdens that might impede safe and sound banking activities. As such, the FDIC has taken numerous actions to tailor our regulatory framework while maintaining safety and soundness, financial stability, and consumer protection.

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[13] *See* Federal Regulators issue joint statement on the use of alternative data in credit underwriting (Dec. 3, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19117.html.*

[14] *See Madden v. Midland Funding, LLC,* 786 F.3d 246 (2d Cir. 2015), *cert. denied,* 136 S. Ct. 2505 (2016).

[15] 12 U.S.C. § 1831d.

[16] *See* FDIC Proposes New Rule Clarifying Federal Interest Rate Authority (Nov. 19, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19107.html.*

[17] *See* FDIC Board Approves Establishment of Advisory Committee of State Regulators (Nov. 19, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19105.html.*

1. Enhanced Prudential Standards

In May 2018, Congress enacted the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA),[18] which set forth specific legislative instructions for regulatory tailoring, including by raising the statutory asset threshold for the application of enhanced prudential standards to $250 billion (while giving the FRB the discretion to apply such standards to firms with assets between $100 billion and $250 billion). Last month, the FDIC, FRB, and OCC finalized a rule that implements a key part of EGRRCPA by establishing four risk-based categories for determining capital and liquidity requirements.[19] Under the rule, requirements for Category I firms (*i.e.,* U.S. global systemically important banks, or G–SIBs) are unchanged, and these institutions remain subject to the most stringent standards. Requirements for Category II, Category III, and Category IV firms (*i.e.,* all other banking organizations with greater than $100 billion in assets) are tiered based on each bank's risk profile.

Beyond the tailoring rule, the FDIC has completed all of its EGRRCPA-mandated rules. Appendix A to this testimony contains a full list of these rules.

2. Company-Run Stress Testing

Just as EGRRCPA raised the asset threshold for the application of enhanced prudential standards from $50 billion to $250 billion, it raised the asset threshold for company-run stress testing requirements from $10 billion to $250 billion. We recently finalized a rule[20] to reflect this statutory change. We are also working on amendments to our interagency stress testing guidance[21] that would further tailor supervisory expectations. Specifically, we are considering raising the asset threshold under the guidance to $100 billion in assets, among other potential changes.

3. Resolution Planning

In 2011, the FDIC and FRB finalized a rule[22] establishing new resolution planning requirements. Over the past 8 years, large firms have improved their resolution strategies and governance, refined their estimates of liquidity and capital needs in resolution, and simplified their legal structures. Consistent with the new statutory asset threshold under EGRRCPA and the agencies' experience with resolution planning, the FDIC and FRB recently issued a final rule[23] to improve the efficiency and effectiveness of the process and exempt smaller regional banks from the requirements. Under the rule, our underlying standards for reviewing resolution plans will not change. With respect to timing, the rule formalizes the agencies' existing practice of requiring U.S. G–SIBs to submit resolution plans every 2 years and requiring other filers to submit plans every 3 years. The rule also introduces a new "targeted resolution plan" that will allow filers to submit a subset of information required by a full resolution plan. Such targeted plans will be submitted every other cycle.

4. Incentive-Based Compensation

In June 2010—a month prior to the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act)[24]—the FDIC, FRB, and OCC issued guidance[25] to help ensure that incentive compensation policies at banking organizations do not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization. In connection with the guidance, then-FRB Governor Daniel Tarullo noted that many large banking organizations had

[18] Pub. L. 115–174 (May 24, 2018), available at *https://www.govinfo.gov/content/pkg/PLAW-115publ174/pdf/PLAW-115publ174.pdf.*

[19] *See* Changes to Applicability Thresholders for Regulatory Capital and Liquidity Requirements, 84 Fed. Reg. 59230 (Nov. 1, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23800.pdf.*

[20] *See* Company-Run Stress Testing Requirements for FDIC-Supervised State Nonmember Banks and State Savings Associations, 84 Fed. Reg. 56929 (Oct. 24, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-10-24/pdf/2019-23036.pdf.*

[21] *See* Supervisory Guidance on Stress Testing for Banking Organizations With More Than $10 Billion in Total Consolidated Assets, 77 Fed. Reg. 29458 (May 17, 2012), available at *https://www.govinfo.gov/content/pkg/FR-2012-05-17/pdf/2012-11989.pdf.*

[22] *See* Resolution Plans Required, 76 Fed. Reg. 67323 (Nov. 1, 2011), available at *https://www.govinfo.gov/content/pkg/FR-2011-11-01/pdf/2011-27377.pdf.*

[23] *See* Resolution Plans Required, 84 Fed. Reg. 59194 (Nov. 1, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23967.pdf.*

[24] Pub. L. 111–203 (July 21, 2010), available at *https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.*

[25] *See* Guidance on Sound Incentive Compensation Policies, 75 Fed. Reg. 36395 (June 25, 2010), available at *https://www.govinfo.gov/content/pkg/FR-2010-06-25/pdf/2010-15435.pdf.*

already implemented certain changes in their incentive compensation policies.[26] Section 956 of the Dodd-Frank Act subsequently directed the FDIC, FRB, OCC, NCUA, Securities and Exchange Commission (SEC), and Commodity Futures Trading Commission (CFTC) to jointly prescribe, within 9 months of the enactment of the law, regulations or guidelines that prohibit any types of incentive-based pay arrangement that encourages inappropriate risks, based on the standards established in the FDI Act.[27] Proposals to implement this statute were issued in 2011[28] and 2016,[29] but neither was finalized. Although the banking agencies' 2010 guidance remains fully intact—and firms have made further changes to their incentive compensation policies following this guidance—the agencies continue to engage in discussions regarding how best to implement the statute.

5. Volcker Rule

One of the most challenging post-crisis reforms for regulators and institutions to implement has been the Volcker Rule, which restricts banks from engaging in proprietary trading and from owning hedge funds and private equity funds. As written and originally implemented, the rule was so complex that it required regulators to issue 21 responses to frequently asked questions (FAQs) within 3 years of its adoption. This complexity has resulted in uncertainty and unnecessary burden, especially for smaller, less-complex institutions.

To address some of these concerns, EGRRCPA exempted from the Volcker Rule all banks below $10 billion in consolidated assets that do not engage in significant trading activity. Earlier this year, the five agencies responsible for implementing the Volcker Rule finalized a rule[30] to codify this exemption.

In addition, the agencies issued a larger set of revisions[31] to the Volcker Rule—sometimes referred to as "Volcker 2.0"—that tailor the rule's compliance requirements by establishing three tiers of banking entities based on level of trading activity for purposes of applying compliance requirements: (1) significant trading assets and liabilities, (2) moderate trading assets and liabilities, and (3) limited trading assets and liabilities.

Banking entities with significant trading assets and liabilities, which hold approximately 93 percent of total trading assets and liabilities across the U.S. banking system, will continue to be subject to the most stringent compliance standards. The revisions also provide greater clarity, certainty, and objectivity about what activities are prohibited under the Volcker Rule. These changes, which apply specifically to the Volcker Rule's proprietary trading prohibition, will improve compliance with the rule and reduce unnecessary burdens while maintaining the statutory prohibition on proprietary trading by covered banking entities.

Additionally, the agencies are currently working on a forthcoming proposal to address the overly broad restrictions associated with covered funds, which the agencies plan to issue for comment as soon as possible.

6. Appraisals

Last year, the FDIC, FRB, and OCC finalized a rule[32] that raised the appraisal threshold for federally related commercial real estate transactions from $250,000—the threshold established in 1994—to $500,000. Earlier this year, the agencies finalized a related rule[33] that raised the appraisal threshold for federally related residential real estate transactions from $250,000—also the threshold established in 1994—to $400,000. These changes balance current market realities and price

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[26] *See* Federal Reserve, OCC, OTS, FDIC Issue Final Guidance on Incentive Compensation (June 21, 2010), available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20100621a.htm.*

[27] Section 956(c) of the Dodd-Frank Act specifically requires the regulators to "take into consideration standards described in section 39(c) of the FDI Act" (12 U.S.C. 2 1831p–1 and 12 U.S.C. 1831p–9 1(c)).in establishing standards.

[28] *See* Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21170 (Apr. 14, 2011), available at *https://www.govinfo.gov/content/pkg/FR-2011-04-14/pdf/2011-7937.pdf.*

[29] *See* Incentive-Based Compensation Arrangements, 81 Fed. Reg. 37670 (June 10, 2016), available at *https://www.govinfo.gov/content/pkg/FR-2016-06-10/pdf/2016-11788.pdf.*

[30] *See* Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 35008 (July 22, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-07-22/pdf/2019-15019.pdf.*

[31] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 84 Fed. Reg. 61974 (Nov. 14, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-11-14/pdf/2019-22695.pdf.*

[32] *See* Real Estate Appraisals, 83 Fed. Reg. 15019 (Apr. 9, 2018), available at *https://www.govinfo.gov/content/pkg/FR-2018-04-09/pdf/2018-06960.pdf.*

[33] *See* Real Estate Appraisals, 84 Fed. Reg. 53579 (Oct. 8, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-10-08/pdf/2019-21376.pdf.*

appreciation, including needs in rural communities where access to appraisal services can be limited, with the need to ensure the safety and soundness of our institutions.

C. Enhancing Resolution Preparedness

In addition to supervising small and medium-sized banks and appropriately tailoring regulations for banks of all sizes, one of the FDIC's most important responsibilities for strengthening the banking system is ensuring that, in the event of financial distress, large and complex banks are resolvable in a rapid and orderly manner under the Bankruptcy Code. In furtherance of this critical goal, we have taken several steps to enhance resolution preparedness.

1. New FDIC Division

Earlier this year, we announced the centralization of our supervision and resolution activities for the largest and most complex banks in a new Division of Complex Institution Supervision and Resolution (CISR).[34] This move is more than just an organizational realignment. Rather, combining these key functions will create a stronger, more coherent approach for bank resolution and supervision by enabling us to take a more holistic approach. On the supervision side, CISR is responsible for overseeing banks with more than $100 billion in assets for which the FDIC is not the primary Federal regulator. On the resolution side, CISR is responsible for executing the FDIC's resolution planning mandates for these institutions. In conjunction with this new division, we established a new position—Deputy to the Chairman for Financial Stability—to focus on financial stability issues, including the resolvability of large banks.

2. Cross-Border Cooperation

Given the cross-border activities of the largest, most systemically important banks, we continue to work with our international counterparts on resolution preparedness. For example, earlier this year we hosted a series of exercises with senior officials in the United States, United Kingdom, and European Banking Union to strengthen coordination on cross-border resolution and enhance understanding of one another's resolution regimes for G–SIBs.[35] In addition, we have established Crisis Management Groups that have brought together firms and home and host authorities to discuss resolution planning. We have developed information-sharing arrangements to support this work and engaged in a number of international operational exercises to test and improve our readiness.

D. Assessing New and Emerging Risks

The FDIC has a long tradition of identifying, analyzing, and addressing key risks in the economy, financial markets, and the banking industry. Through numerous publications, including an annual *Risk Review,* we advance the goal of strengthening the banking system by highlighting risks at a stage when policymakers, bankers, and the public can act to mitigate their scope and impact.

1. Cyber and Resiliency

The FDIC continues to actively monitor cybersecurity risks in the banking industry. FDIC examiners conduct examinations to ensure that financial institutions are appropriately managing their exposure to cybersecurity risk. Our examiners verify that bank management has considered how cyber events could disrupt their operations and has designed resilience into their operations.

Working with our regulatory partners through the Federal Financial Institutions Examination Council (FFIEC), we recently issued an updated *Business Continuity Management* booklet, which describes key principles and practices in this area.[36] The booklet also helps examiners to evaluate the adequacy of an entity's business continuity management program and to determine whether management adequately addresses risks related to the availability of critical financial products and services. The FDIC will continue to engage with other regulators and the private sector to monitor and respond to the risks posed by cyber threats.

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[34] *See* FDIC to Centralize Key Aspects of Its Large, Complex Financial Institution Activities (June 27, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19056.html.*

[35] *See* United States, European Banking Union, and U.K. Officials Meet for Planned Coordination Exercise on Cross-Border Resolution Planning (Apr. 9, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19033.html.*

[36] *See* FDIC FIL–71–2019, Updated FFIEC IT Examination Handbook—Business Continuity Management Booklet (Nov. 14, 2019), available at *https://www.fdic.gov/news/news/financial/2019/fil19071.html.*

2. Bank Secrecy Act/Anti-Money Laundering (BSA/AML)

BSA/AML laws and regulations are a vital component of U.S. efforts to prevent unlawful financial transactions that help fund criminals, terrorists, and other illicit actors. As these actors use increasingly sophisticated methods to conceal their transactions in an evolving financial, technological, and regulatory landscape, the FDIC continues to work with other regulators and the law enforcement and intelligence communities to help supervised institutions respond to these threats.

At the same time, BSA/AML laws and regulations impose significant compliance costs on the entire system and on the individual institutions that shoulder the reporting burdens. For example, although the information gathered by suspicious activity reports (SARs) can be useful, it can be burdensome for institutions—particularly community banks—to file SARs. Federal regulatory agencies are working to develop better ways to communicate the value of SARs to the bankers that incur the reporting cost. The government also must continue to examine the rules it imposes to ensure that the system is effective and the obligations imposed on institutions are not unduly burdensome. It is also essential that we support the use of technology to both prevent illicit activity and to strengthen the collaboration among banks, regulators, and the law enforcement and intelligence communities.

To advance the parallel goals of cost effectiveness and greater system-wide efficiency, the FDIC, FRB, OCC, NCUA, and the U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN) jointly issued a statement [37] to address instances in which banks may decide to enter into collaborative arrangements to share resources to manage their BSA/AML obligations more efficiently and effectively. For example, banks use such arrangements to pool human, technology, or other resources to reduce costs, increase operational efficiencies, and leverage specialized expertise. In addition, the FDIC, FRB, OCC, NCUA, and FinCEN issued a statement [38] to encourage banks to consider, evaluate, and, where appropriate, responsibly implement innovative approaches to meet their BSA/AML obligations. The agencies recognized that innovation has the potential to help banks address these risks.

3. Leveraged Lending and Corporate Debt

Nonfinancial corporate debt as a share of gross domestic product (GDP) has reached a record level of 49.6 percent.[39] The increase has been driven by corporate bonds and leveraged loans, which have grown faster than other types of corporate debt. Although banks do not hold a significant amount of corporate bonds, direct bank exposure to corporate debt is concentrated in leveraged loans, collateralized loan obligations (CLOs), commercial and industrial loans, and commercial mortgages. In addition, indirect exposures, such as those arising from loans to CLO arrangers, could transmit stress from the corporate sector into the banking system. The FDIC is carefully monitoring these risks. We recently published a paper [40] discussing the growth in corporate debt and examining bank exposure to the growth of leveraged loans and continue to engage with other regulatory agencies on this issue.

4. Growth in Nonbank Mortgage Origination and Servicing

As the FDIC remains vigilant to the risks facing banks, we also monitor the evolution of the financial system, including the migration of certain financial activities to nonbanks. Perhaps the most prominent example of this shift has been in mortgage origination and servicing. We recently published a paper [41] analyzing this dynamic and associated risks. Among other things, the paper finds that the growth of nonbanks in mortgage origination and servicing has largely been attributed to the rapid expansion by nonbanks, mortgage-focused business models and technological innovation of nonbanks, litigation regarding financial crisis-era legacy portfolios at

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[37] *See* FDIC FIL–55–2018, Bank Secrecy Act: Interagency Statement on Sharing Bank Secrecy Act Resources (Oct. 3, 2018), available at *https://www.fdic.gov/news/news/financial/2018/fil18055.html.*

[38] *See* FDIC FIL–79–2018, Bank Secrecy Act: Interagency Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing (Dec. 3, 2018), available at *https://www.fdic.gov/news/news/financial/2018/fil18079.html.*

[39] *See* FDIC Annual Publication Examines Potential Credit and Market Risks (July 30, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19070.html.*

[40] *See* Leveraged Lending and Corporate Borrowing: Increased Reliance on Capital Markets, With Important Bank Links, available at *https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article2.pdf.*

[41] Trends in Mortgage Origination and Servicing: Nonbanks in the Post-Crisis Period, available at *https://www.fdic.gov/bank/analytical/quarterly/2019-vol13-4/fdic-v13n4-3q2019-article3.pdf.*

the largest bank originators, large bank sales of legacy servicing portfolios, and changes to the capital treatment of mortgage servicing assets applicable to banks. As regulators and policymakers seek to better understand the implications of this migration, we must consider both the benefits and the risks.

E. Creating the Workforce of the Future

It goes without saying that the FDIC's ability to fulfill its mission depends on having an experienced, knowledgeable, and agile workforce. To this end, I am honored to work alongside 6,000 dedicated FDIC employees who come to work every day focused on protecting consumers and strengthening the banking system. As banks have evolved with the use of new technology and delivery channels, however, so should the FDIC's workforce. In order to maintain and reinforce the quality of our workforce—and improve its diversity—in this constantly changing environment, we have taken several steps I would like to highlight.

1. Retention

We are seeking to bolster retention by striving to reduce our examiners' travel time, which is one of the primary reasons examiners leave the agency. When I joined the FDIC, safety and soundness examiners spent an average of 89 nights per year away from home. We are striving to reduce that number, and our supervision modernization efforts will help. Employing better technology provides our team the flexibility to perform significant portions of the examination offsite, whether at home while teleworking or in a local field office. Using enhanced technology will help us strike the right balance between onsite and offsite supervision activities, thereby providing better work-life balance for employees and reducing the supervisory burden for institutions.

2. Recruiting

To support our supervision modernization efforts, we looked at how to build the workforce of the future. Our goal is to attract, retain, and promote a diverse and engaged workforce with the knowledge, skills, and abilities to effectively execute the mission of the FDIC, keeping pace with industry changes. Examiners represent about one-third of our workforce and are tasked with performing the core business function of the agency.

Until recently, we typically hired generalists into a commissioned examiner training program. That program did not meet our business needs; attrition outpaced our commissioning process, the protracted speed-to-commissioning time resulted in significant attrition, and we were challenged to get our work done.

This year, we pulled together a team of executives to conduct a review of our entry-level examiner hiring and corporate perspective training to recommend changes to improve efficiency and effectiveness. We changed the way we recruit, hire, and train to meet the needs of a changing industry and workforce and to speed the time to commission by up to 1 year.

3. Specialists

Earlier this year, the FDIC established a new office of innovation, the FDIC Tech Lab (FDiTech), with a focus on how to best utilize technology to meet consumer demands while maintaining safety, soundness, and consumer protection. The success of this office will depend on the caliber of its personnel. We are seeking a wide range of technologists to join the agency, including a Chief Innovation Officer, data scientists, process engineers, software developers, and network security experts who can reshape our supervisory approach in a rapidly evolving digital world.

We are also supplementing our examiner cadre with specialists and analysts in both information technology and loan review. These individuals will complement our workforce by providing assistance on critical areas of the examination. Although they will never replace commissioned examiners as our primary hiring target, they will contribute significantly to our supervision program.

4. Diversity

My personal and professional experiences have underscored the importance of a workplace that is free from discrimination and that supports diversity and inclusion. In furtherance of the FDIC's longstanding commitment to diversity and inclusion, we have created an executive-level taskforce on diversity. The taskforce will help to ensure our recruiting resources, hiring decisions, interviewing processes, retention efforts, and advancement pools reflect a purposeful and intentional effort to leverage diversity to maintain a high-performing examination workforce.

The racial, ethnic, and gender diversity of the FDIC workforce continues a steady increase since 2010 with minority representation at nearly 30 percent and with women comprising nearly 45 percent of permanent employees. We have also continued our efforts to promote the participation of Minority and Women-Owned Businesses in FDIC contracting actions. We will work to consistently improve the representation of women and minorities at all levels of the agency and seamlessly integrate veterans and people with disabilities. We will continue to foster an environment without barriers in which all employees feel welcomed, valued, respected, and engaged.

5. New Compensation Agreement and New Benefits

Earlier this year, the FDIC and the National Treasury Employees Union (NTEU) reached a new compensation agreement that includes two significant new benefits to enhance work-life balance for employees.

First, the FDIC will provide 6 weeks of paid parental leave for the birth, adoption, or foster care of a child.[42] This benefit, which will be in addition to any leave entitlement under the Family and Medical Leave Act, will enable growing families to thrive and help to ensure that no FDIC employee feels forced to choose between work and family. I am proud that the FDIC is a leader in this space as one of the first Federal Government agencies to offer this benefit.

Second, the agreement calls for a Pilot Student Loan Repayment Program, which will target commissioned examiner employees over a 3-year period. During these 3 years, up to 100 employees each year will be eligible to have their student loans paid directly, up to $500 per month for a total of up to $18,000 per employee. The pilot is designed to provide meaningful financial assistance to employees and contribute to FDIC retention goals. If successful, the FDIC will consider expansion of the program to other categories of positions with recruitment or retention challenges.

In addition to these work-life benefits, the agreement includes compensation increases for the next 3 years and shifts a portion of an employee's annual pay increase to a bonus component, which will help the FDIC reward its highest performers in a sustainable and fiscally responsible manner. To improve performance management and support the new bonus component of pay, the agreement also provides for a simplified, two-level performance management system, which will replace the current five-level rating system. The new system will be designed to enhance communication between employees and their supervisors, and it will also help identify and reward outstanding performance under the new bonus structure.

III. Ensuring That FDIC-Supervised Institutions Can Meet the Needs of Consumers and Businesses

Economic growth across the Nation is predicated on the ability of banks to provide safe and secure financial products and services to consumers and businesses. Although modernizing our supervisory and enforcement programs and tailoring regulations based on an institution's risk profile are matters of good government and steps toward a stronger banking system, there are certain areas in which the needs of consumers and businesses must be addressed by more comprehensive reforms.

I have embarked on a 50-State listening tour to hear from banks directly about their challenges and to learn about the needs of the consumers and businesses that banks serve. At the outset of this effort, I emphasized the need to reverse the trend of having those affected by our regulations come to Washington to have their voices heard, but instead to meet them on their home turf. With 26 State visits, I am now more than halfway through this listening tour, which has provided valuable feedback and has underscored the importance of seeking perspectives outside of the "beltway." The following issues represent an attempt to address some of the concerns that have been brought to our attention.

A. Brokered Deposits and Interest Rate Caps

The FDIC is undertaking a comprehensive review of our longstanding regulatory approach to brokered deposits and the interest rate caps applicable to banks that are less than well capitalized. Since the statutory brokered deposit and rate restrictions applicable to less than well capitalized banks were put in place in 1989 (and amended in 1991), the financial services industry has seen significant changes in technology, business models, and products. In February, we issued an advance notice of proposed rulemaking (ANPR)[43] to seek public comment on all aspects of these regulations.

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[42] *See* FDIC Announces New Paid Parental Leave Benefit for Employees (Oct. 9, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19089.html.*

[43] *See* Unsafe and Unsound Banking Practices: Brokered Deposits and Interest Rate Restrictions, 84 Fed. Reg. 2366 (Feb. 6, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-02-06/pdf/2018-28273.pdf.*

After considering feedback from the ANPR, we expedited the interest rate cap component of this review and proposed a rule[44] that would amend the methodology for calculating the national rate and national rate cap for specific deposit products. Under the proposal, the national rate cap for particular products would be set at the higher of the 95th percentile of rates paid by insured depository institutions (IDIs) weighted by each institution's share of total domestic deposits, or the proposed national rate plus 75 basis points. The proposed rule would also greatly simplify the current local rate cap calculation and process by allowing less than well capitalized institutions to offer up to 90 percent of the highest rate paid on a particular deposit product in the institution's local market area.

We have also been working to propose a rule regarding our brokered deposits framework. We are preparing an updated framework with several goals in mind, including encouraging innovation to allow banks to reach customers using emerging technology and through new channels, minimizing risk to the DIF, consistency with the statute, and establishing a transparent, consistent process. We expect to issue that proposal later this month.

B. CRA Regulations

The regulations implementing the CRA have not been updated in 20 years. During this period, the banking industry has undergone transformative changes. As the industry continues to evolve, many stakeholders believe that the current regulations implementing the CRA do not fully achieve their statutory purpose (*i.e.,* encouraging banks to help meet the credit needs of the communities they serve, including low- and moderate-income areas). As part of an effort to update these regulations, the OCC issued an ANPR[45] last year seeking feedback on how the CRA could be modernized to improve the effectiveness of the law and provide much needed clarity to financial institutions on what activities receive CRA "credit." The banking agencies have reviewed the comment letters received by the OCC, and the FDIC is currently engaged with the OCC and FRB on how to revise the regulatory framework that can help meet these dual goals.

C. Small-Dollar Lending

According to a recent FRB study, nearly 4-in-10 households cannot cover a $400 emergency expense with cash.[46] Moreover, according to our unbanked and underbanked study, over 20 million households in America are underbanked and over 8 million are unbanked.[47] While some banks offer small-dollar lending to help those in need, many banks have chosen not to offer such products, in part, due to regulatory uncertainty.[48] As a result, many families rely on nonbank providers to cover these emergency expenses, or their needs go unmet. To solicit feedback on these products and consumer needs, the FDIC issued a request for information[49] last year to learn more about small-dollar credit needs and concerns. We have reviewed more than 60 comments and are reviewing our existing guidance and policies to ensure

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[44] *See* Interest Rate Restrictions on Institutions That Are Less Than Well Capitalized, 84 Fed. Reg. 46470 (Sep. 4, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-09-04/pdf/2019-18360.pdf.*

[45] *See* Reforming the Community Reinvestment Act Regulatory Framework, 83 Fed. Reg. 45053 (Sept. 5, 2018), available at *https://www.govinfo.gov/content/pkg/FR-2018-09-05/pdf/2018-19169.pdf.*

[46] *See* Federal Reserve Board Report on the Economic Well-Being of U.S. Households in 2017 (May 2018), available at *https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf.*

[47] *See* 2017 FDIC National Survey of Unbanked and Underbanked Households, available at *https://www.fdic.gov/householdsurvey/2017/2017report.pdf.* A household is classified as unbanked if no one in the household has a checking or savings account. A household is classified as underbanked if it has a checking or savings account and used one of the following products or services from an alternative financial services provider in the past 12 months: money orders, check cashing, international remittances, payday loans, refund anticipation services, rent-to-own services, pawn shop loans, or auto title loans.

[48] The FDIC, FRB, and OCC have taken separate approaches to small-dollar lending at the institutions they regulate. *See* FDIC Issues Final Guidance Regarding Deposit Advance Products (Nov. 21, 2013), available at *https://www.fdic.gov/news/news/press/2013/pr13105.html;* FDIC FIL–50–2007, Affordable Small-Dollar Loan Guidelines (June 19, 2007), available at: *https://www.fdic.gov/news/news/financial/2007/fil07050.pdf;* OCC Bulletin 2018–14, Core Lending Principles for Short-Term, Small-Dollar, Installment Lending (May 23, 2018), available at: *https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html;* Federal Reserve Statement on Deposit Advance Products (April 25, 2013), available at: *https://www.federalreserve.gov/supervisionreg/caletters/caltr1307.htm.*

[49] *See* Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58566 (Nov. 20, 2018), available at *https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf.*

that they do not impose impediments to banks considering the extension of responsible small-dollar credit to consumers.

D. Initial Margin

In the aftermath of the financial crisis, Congress mandated that regulators establish capital and margin requirements for noncleared swaps. In 2015, the banking agencies adopted regulations implementing these requirements.[50] In addition to requiring the exchange of initial and variation margin with unaffiliated counterparties, the rule requires that IDIs collect initial and variation margin from affiliates. After carefully reviewing these regulations, the agencies issued a proposal[51] to repeal the requirement that IDIs collect initial margin from affiliates while retaining the requirement that IDIs exchange variation margin with affiliates. The proposal, which would harmonize the banking agencies' framework with the rules finalized by international regulators, the SEC, and the CFTC, does not change the margin requirements for transactions with unaffiliated counterparties, but covers only transactions between an IDI and its affiliates. The removal of the inter-affiliate initial margin requirement would provide banking organizations with additional flexibility for internal allocation of collateral. We believe that such risk management practices often improve the safety and soundness of a covered swap entity.

E. Minority Depository Institutions

Preserving and protecting minority depository institutions (MDIs) remains a priority for the FDIC, and we have undertaken a number of initiatives to support MDIs, with a specific emphasis on partnerships. In June, we hosted a roundtable in Washington with 10 large banks and seven minority banks.[52] Each participant outlined in advance the types of partnerships they were seeking and, during the roundtable, MDIs and large banks met one-on-one to explore partnership opportunities. Following the roundtable, several large banks expressed appreciation for the opportunity to find mutually beneficial partnerships and eagerness to begin working with MDIs to help them have a greater impact on their communities. One of the large banks drafted a proposal to expand its partnerships beyond the seven MDIs at the roundtable, and one of the MDIs reported that it had partnered with three larger banks from the event on a variety of technical assistance efforts. This is exactly the type of outcome we were hoping for, and the FDIC stands ready to serve as a resource for any MDI that wants to partner with large banks—or any other bank that wants to partner with MDIs—and has questions about next steps. Based on the success of the June event, the FDIC held similar roundtables in Atlanta and Chicago this year and plans to host additional events in the Midwest and on the West Coast next year.

In addition, the FDIC appointed additional minority bankers to our CBAC and established a new MDI Subcommittee to the CBAC to highlight MDI efforts in their communities and to provide a platform for MDIs to exchange best practices.[53]

Like many other community banks, MDIs face challenges from the evolving financial services landscape. The boards and management of institutions must successfully navigate economic, technological, competitive, and regulatory circumstances to be profitable and serve their communities. For many MDIs, these challenges can be amplified if they serve economically distressed communities that do not fully recover during economic growth cycles. As the supervisor of nearly 100 MDIs—two-thirds of all MDIs nationwide—the FDIC is committed to promoting and sustaining the vibrant role these banks play in their communities. Increasing our engagement with MDIs enables us to understand their unique needs and provide tools and resources so they can help create jobs, grow small business, and build wealth in their communities.

IV. Fostering Technology Solutions and Encouraging Innovation at Community Banks

While the modernization efforts I have discussed are critical, perhaps no issue is more important—or more central to the future of banking—than innovation. Tech-

[50] *See* Margin and Capital Requirements for Covered Swap Entities, 80 Fed. Reg. 74840 (Nov. 30, 2015), available at *https://www.govinfo.gov/content/pkg/FR-2015-11-30/pdf/2015-28671.pdf.*

[51] *See* Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59970 (Nov. 7, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-11-07/pdf/2019-23541.pdf.*

[52] *See* FDIC Hosts Roundtable on Collaborations with Minority Depository Institutions (June 27, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19057.html.*

[53] *See* FDIC Hosts Interagency Conference Focusing on Minority Depository Institutions (June 25, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19054.html.*

nology is transforming the business of banking, both in the way consumers interact with their bank and the way banks do business. I recently discussed several important ways technology could further transform banking, including digitization, data access and open banking, machine learning and artificial intelligence, and personalization.[54] Given these and other developments, regulators cannot play "catch up," but must be proactive in engaging with all stakeholders, including banks, consumer groups, trade associations, and technology companies to understand and help foster the safe adoption of technology across the banking system, especially at community banks.

A. Encouraging Innovation and Partnerships

Banks know that if they do not innovate, they will lose in the long run. At the FDIC, we have asked, if banks know that they must innovate, why more community banks are not developing or utilizing new technologies.

We have received two principal explanations: (1) cost and (2) regulatory uncertainty. In many cases, the cost to innovation is prohibitively high for community banks, which often lack the expertise, information technology, and research and development budgets to independent develop and deploy their own technology. As a result, partnerships with financial technology companies, or fintechs, that have already developed, tested, and rolled out new technology are often critical for these banks and their communities. Yet, if our regulatory framework does not evolve with technological advances in a manner that enables partnerships between banks and fintechs, such innovation may not occur at community banks.

Regulatory modernization is not optional for the FDIC. We must lay this foundation because the survival of our community banks depends on it. These banks face challenges from industry consolidation, economies of scale, and competition from their community bank peers, larger banks, credit unions, fintechs, and nonbanks lenders. My goal is for the FDIC to lay the foundation for the next chapter of banking by encouraging innovation and partnerships, allowing banks and their communities to benefit from new products and services that improve people's lives.

With this goal in mind, FDiTech, the FDIC's new office of innovation, will collaborate with community banks on how to deploy technology in delivery channels and back office operations to better serve customers. Many of the institutions we supervise are already innovating, but a broader adoption of new technologies will allow community banks to stay relevant in the increasingly competitive marketplace.

We have identified three key ways in which FDiTech can work to encourage innovation and partnerships at community banks. First, through engagement and technical assistance we can help eliminate the regulatory uncertainty that prevents some banks from adopting new technologies. Second, through tech sprints—which are designed to challenge innovators to develop technological solutions to address specific challenges—we can help encourage the market to develop technology that improves the operations of financial institutions and how the FDIC functions as a regulatory agency. Third, through pilot programs we can work with developers to pilot products and services for truly innovative technologies. Over the coming months, the FDIC will play a convening role to encourage community bank consideration of how technological developments could impact their businesses and to ensure community bank perspectives are considered in industry-led efforts to establish standards. We will also host a series of community bank-focused stakeholder roundtables on digitization, data access and ownership, machine learning and artificial intelligence, and personalization of the banking experience.

B. Reducing Regulatory Burden

As we consider these medium-to-long-term ways to encourage innovation and partnerships, we have simultaneously taken important short-term steps to reduce the regulatory burden at community banks. These changes should enable innovation at community banks by allowing them to spend less time navigating complex regulatory issues and more time managing their businesses.

Last month, the FDIC, FRB, and OCC finalized a rule[55] that implements EGRRCPA by establishing a simple leverage ratio for qualifying community banks. Under the rule, qualifying banks that elect to maintain a leverage ratio of greater than 9 percent will be considered to have satisfied the generally applicable risk-based and leverage capital requirements in the agencies' capital rules and, if appli-

[54] *See* FDIC Chairman Jelena McWilliams, "The Future of Banking," speech before the Federal Reserve Bank of St. Louis (Oct. 1, 2019), available at *https://www.fdic.gov/news/news/speeches/spoct0119.html.*

[55] *See* Regulatory Capital Rule: Capital Simplification for Qualifying Community Banking Organizations, 84 Fed. Reg. 61776 (Nov. 13, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-11-13/pdf/2019-23472.pdf.*

cable, will be considered to have met the well-capitalized ratio requirements for purposes of section 38 of the FDI Act. Notably, the agencies estimate that over 80 percent of community banks will qualify to use the community bank leverage ratio. The rule provides meaningful regulatory compliance burden relief by allowing these banks to avoid complex risk-based capital calculations and reporting.

Earlier this year, the FDIC, FRB, and OCC finalized a separate rule [56] that implements EGRRCPA by simplifying the Call Report for community banks for the first and third calendar quarters and expanding the eligibility to file the most streamlined Call Report to include most IDIs with less than $5 billion in total assets.

V. Conclusion

Since 1933, the FDIC has played a vital role in maintaining stability and public confidence in the Nation's financial system. This mission remains as critical today as it was more than 86 years ago, but if we are to achieve our mission in the modern financial environment, while still allowing the industry to evolve and innovate, the agency cannot be stagnant.

Thank you again for the opportunity to testify today, and I look forward to answering your questions.

[56] *See* Reduced Reporting for Covered Depository Institutions, 84 Fed. Reg. 29039 (June 21, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-06-21/pdf/2019-12985.pdf.*

Appendix A

Status of Rulemakings under the Economic Growth, Regulatory Relief, and Consumer Protection Act

SECTION	DESCRIPTION	STATUS
103	**Appraisals** Amends the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 to exempt certain real property mortgage transactions from appraisal requirements	Final Rule published October 8, 2019
201	**Community Bank Leverage Ratio** Exempts banks with less than $10 billion in assets and that meet other requirements — including limits on off-balance sheet exposures, trading assets and liabilities, total notional derivatives exposures, and other factors — from existing risk-based capital ratio and leverage ratio requirements provided they exceed a community bank leverage ratio	Final Rule published November 13, 2019
202	**Reciprocal Deposits** Amends Section 29 of the Federal Deposit Insurance Act to except a capped amount of certain reciprocal deposits from treatment as brokered deposits for qualifying institutions	Final Rule published February 4, 2019
203, 204	**Volcker Rule** Exempts banks with less than $10 billion in assets and total trading assets and liabilities of no more than 5 percent of total consolidated assets from the Volcker Rule	Final Rule published July 22, 2019
205	**Short Form Call Reports** Requires regulations that allow reduced call reporting for the first and third quarters for certain banks with less than $5 billion in assets	Final Rule published June 21, 2019

SECTION	DESCRIPTION	STATUS
210	**Examination Cycle** Increases the size threshold for well-capitalized banks to be eligible for an 18-month examination cycle from $1 billion to $3 billion in total assets, and authorizes the banking agencies to make corresponding changes for 2-rated institutions	Final Rule published December 28, 2018
214	**HVCRE/ADC** States that the appropriate federal banking agencies may assign heightened risk weights for high-volatility commercial real estate (HVCRE) loans only to those loans that meet a statutory definition of HVCRE	Final Rule approved by FDIC Board November 19, 2019; awaiting publication in *Federal Register*
401	**Tailoring Capital and Liquidity Rules for Large Domestic and Foreign Banking Organizations** Raises the threshold for application of enhanced prudential standards to bank holding companies, including capital and liquidity rules, from $50 billion to $250 billion in total consolidated assets and allows the FRB to apply enhanced prudential standards to any bank holding company with between $100 billion and $250 billion in total consolidated assets under certain circumstances	Final Rule published November 1, 2019
401	**Resolution Plans** Raises the threshold for application of enhanced prudential standards to bank holding companies, including the requirement to file section 165(d) resolution plans, from $50 billion to $250 billion in total consolidated assets and allows the FRB to apply enhanced prudential standards to any bank holding company with between $100 billion and $250 billion in total consolidated assets under certain circumstances	Final Rule published November 1, 2019

SECTION	DESCRIPTION	STATUS
401	**Company-Run Stress Tests** Amends the requirements for company-run stress tests by: raising the threshold from $10 billion to $250 billion in assets; making the stress tests periodic rather than annual; and removing the adverse scenario (leaving intact the baseline and severely adverse sets of stress test conditions)	Final Rule published October 24, 2019
402	**Supplementary Leverage Ratio for Custodial Banks** Requires the appropriate federal banking agencies to amend their capital regulations to exempt funds of a custodial bank held at certain central banks when calculating the supplementary leverage ratio	Final Rule approved by FDIC Board November 19, 2019; awaiting publication in *Federal Register*
403	**High-Quality Liquid Assets (HQLA)** Requires the federal banking agencies to amend their liquidity coverage ratio regulations to treat municipal obligations that are "investment grade" and "liquid and readily marketable" as level 2B liquid assets not later than 90 days after enactment	Final Rule published June 5, 2019

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Congressional Testimony

Rodney E. Hood
Chairman
National Credit Union Administration

Senate Committee on Banking, Housing, and Urban Affairs

Hearing on Oversight of Financial Regulators

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Congressional Testimony

Chairman Crapo, Ranking Member Brown, and Members of the Committee, as Chairman of the National Credit Union Administration (NCUA) Board, I appreciate the invitation to testify today about the state of the credit union industry and to provide background on the NCUA's most recent initiatives.

The NCUA's mission is to "provide, through regulation and supervision, a safe and sound credit union system, which promotes confidence in the national system of cooperative credit."[1] This system is vital to the American economy, touching more than one-third of all U.S. households.[2] In turn, the NCUA is charged with, and focused on, ensuring the safety and soundness of the National Credit Union Share Insurance Fund (Share Insurance Fund). The agency takes seriously our paramount responsibilities to regulate and supervise approximately 5,281 federally insured credit unions with more than 119.5 million member-owners and more than $1.53 trillion in assets across all states and U.S. territories.[3] As part of that mission, we have developed initiatives to help credit unions, within the bounds of safety and soundness, serve their members more effectively, including members of modest means and those in underserved areas.[4]

I will first focus on the strong state of the credit union industry and the Share Insurance Fund and then discuss the NCUA's efforts to meet the goals the agency set out in our *2018–2022 Strategic Plan*:[5]

(1) Ensuring a safe and sound credit union system;
(2) Providing a regulatory framework that is transparent, efficient, and improves consumer access; and
(3) Maximizing organizational performance to enable mission success.

In describing how the NCUA is meeting these goals, I will focus on the NCUA Board's ongoing efforts to improve the agency's efficiency and effectiveness in light of the ever-changing financial services marketplace. The NCUA is striving to reduce the

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[1] See NCUA Mission and Vision, https://www.ncua.gov/about-ncua/mission-values.
[2] NCUA calculations using the Federal Reserve's *Survey of Consumer Finances, 2016*.
[3] Based on September 30, 2019, Call Report Data.
[4] *Serving the Underserved*, National Credit Union Administration, https://www.ncua.gov/support-services/credit-union-resources-expansion/field-membership-expansion/serving-underserved. The Federal Credit Union Act, the statute governing this agency and federally insured credit unions, specifies that this national system is intended to meet "the credit and savings needs of consumers, especially persons of modest means." Credit Union Membership Access Act, Pub. L. No. 105-219, § 2(4), 112 Stat. 913, 914 (1998).
[5] See *NCUA's 2018–2022 Strategic Plan*, https://www.ncua.gov/files/agenda-items/AG20180125Item3b.pdf.

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regulatory, reporting, and examination burdens facing credit unions without sacrificing the safety and soundness of the credit union system and, in turn, the Share Insurance Fund.

I will also address some of the ways we are promoting financial inclusion and making it easier for credit unions to serve their members more effectively, including the underserved, those of modest means, people with disabilities, and those in vulnerable communities.

State of the Credit Union Industry and the Share Insurance Fund

Federally insured credit unions continued to perform well in 2019. As of September 30, 2019, credit union membership had grown by more than 3 percent over the preceding year to more than 119 million members. Assets in the credit union system increased to $1.53 trillion, and the system's aggregate net worth ratio stood at 11.39 percent, well above the 7-percent statutory level for well-capitalized credit unions.

As I said in my testimony before the Committee in May, the NCUA continues to be a responsible steward of agency funds and remains dedicated to sound financial management practices. In May, the agency paid dividends to more than 5,500 institutions eligible for a $160.1 million Share Insurance Fund distribution. This was part of the nearly $900 million in equity distributions the agency has issued over the last 18 months; money that is going back into communities to support small businesses, promote economic growth, and improve the financial well-being of credit union members across the country.

Examination and Supervision of Regulated Entities

The NCUA's supervision of federally insured credit unions consists of periodic onsite examinations and continuous offsite monitoring. The examination program is designed to deploy resources on a proportionate basis, taking into account the risk profile and size of institutions. The frequency with which the NCUA conducts examinations is consistent with the approach of the federal banking agencies.

Lower-risk federal credit unions with assets of less than $1 billion may qualify for an examination every 14 to 20 months, while all other federal credit unions receive an examination every 8 to 14 months. For federally insured, state-chartered credit unions, NCUA coordinates examination timing with state supervisors.

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Additionally, the agency has a three-tiered exam program based on a credit union's asset size and risk profile. The Small Credit Union Examination Program is targeted to federal credit unions with total assets of less than $50 million and a CAMEL composite rating of 1, 2, or 3. Small credit unions that are financially and operationally sound and present a lower risk will typically have shorter examinations and more concise examination reports.

The NCUA uses a risk-focused examination program for credit unions between $50 million and $10 billion in assets. During these examinations, field staff review areas that have the highest potential risk and evaluate a credit union's compliance with federal regulations.

Lastly, the agency has a separate program to identify, mitigate, and manage the risk in large consumer credit unions, those with assets greater than $10 billion. The large credit union program includes a continuous supervision model, including enhanced off-site monitoring and data analysis. Further, these institutions are subject to capital planning and stress testing requirements to assess their financial condition and risks over the planning horizon under both expected and adverse conditions. The examinations conducted in large consumer credit unions are also subject to heightened quality control, which is conducted by the NCUA's Office of Examination and Insurance.

The agency's examination and supervision program provides for active risk management and early detection of problems, which is critical to preserving the financial strength and well-being of the system. The NCUA strives to detect and resolve problems in credit unions before they become insurmountable. Of course, the NCUA takes credit unions' compliance with legal requirements seriously, and, when necessary, takes various administrative actions to compel institutions to correct violations of law. The agency has a variety of enforcement authorities available to it and carefully considers the types of enforcement actions that would be most effective.

Because fines imposed on credit unions must be paid by credit unions' member-owners, which ultimately takes money out of communities served, the NCUA makes judicious use of its civil money penalty authority. The NCUA favors using administrative actions when a credit union is not operating in a safe and sound manner, complying with applicable statutory and regulatory requirements fully, or both.

The NCUA uses both informal and formal actions to achieve resolution of problems. Informal actions include: documents of resolution, regional director letters, unpublished letters of understanding and agreement, and preliminary warning letters. Formal actions include: published letters of understanding and agreement, cease and desist orders, involuntary liquidations, conservatorships, removals, prohibitions, terminations of insurance, and revocation of charters.

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The particular administrative action or progression of actions the NCUA uses depends on the facts and circumstances of the particular case. Based on our decades of experience, we have learned that most problems can be resolved through informal actions.

The NCUA does impose civil money penalties on credit unions from time to time. The amounts of those penalties are small, designed to correct the immediate problem, and are usually assessed in response to a credit union's failure to submit Call Reports or other required data to the NCUA in a timely manner. In these limited circumstances, we have found that small civil money penalties are effective.

Cybersecurity and Technology

Credit unions compete in a dynamic and changing marketplace where they face many evolving challenges and threats. Because of this, the NCUA is bringing fresh thinking to our regulatory approach to ensure that the credit union system remains safe and sound.

Cybersecurity is a priority across the financial system, both for institutions and regulators, and across the federal government. Information technology and cybersecurity have become an integral and ubiquitous part of the delivery of financial services. While advances in technology have generated vast benefits and efficiencies, they have come with emerging risks and threats. It is essential that the NCUA strike the right balance between promoting innovation and ensuring security. Credit unions must be able to safely and securely use technology to deliver member services and to adopt financial innovations to ensure the industry's long-term success.

NCUA's Cybersecurity Initiatives

This year, I appointed a cybersecurity advisor that reports directly to the Chairman of the NCUA, Mr. Johnny E. Davis, Jr. Under my leadership, and with the advice of Mr. Davis, the NCUA has adopted key cybersecurity initiatives in addition to our overall cybersecurity examination program:

- First, we are advancing consistency, transparency, and accountability within the NCUA's cybersecurity examination program;
- Next, we provide credit unions with information and resources to improve their preparedness and resiliency. This includes sharing best practices for cybersecurity to help credit unions successfully carry out their responsibilities; and
- Finally, we have established and improved safeguards to ensure that the NCUA's systems and the information we collect are secure.

The specific program activities associated with the NCUA cybersecurity initiatives are as follows:

Information Security Maturity Assessments

The NCUA established an *Assisted Information Security Maturity Self-Assessment Program* for credit unions in 2018. We did this by benchmarking and customizing the Cybersecurity Assessment Tool developed by the Federal Financial Institutions Examination Council (FFIEC).[6]

Ultimately, we created a specialized Automated Cybersecurity Examination Toolbox for credit unions, which we call the ACET. A central element of the ACET is an assessment of a credit union's cybersecurity maturity. This maturity assessment allows the NCUA and credit unions to determine the maturity of a credit union's information security program by answering as series of 500 questions. The questions assess five specific domains:

- Cyber Risk Management and Oversight;
- Threat Intelligence and Collaboration;
- Cybersecurity Controls;
- External Dependency Management; and
- Incident Management and Resilience.

We perform an ACET maturity assessment on each credit union at least once every four years. In the years we do not perform a full ACET maturity assessment, we incorporate an emphasis on critical security controls in a credit union's regularly scheduled examination. At the conclusion of the initial four-year cycle, the NCUA will have established a baseline for each credit union assessed and a benchmark for where the credit union industry stands against other financial services institutions. A subsequent four-year cycle will identify the progress the credit union industry has made in strengthening its cybersecurity maturity.

Specifically, the NCUA has conducted, and will conduct future, ACET maturity assessments, as follows:

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[6] FFIEC Cybersecurity Assessment Tool, https://www.ffiec.gov/pdf/cybersecurity/FFIEC_CAT_May_2017.pdf

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- In 2018, all scheduled institutions with $1 billion or more in assets were assessed; [7]
- In 2019, all scheduled institutions that have between $250 million and $1 billion in assets have been assessed; and
- In 2020, all scheduled institutions that have between $100 million and $250 million in assets will be assessed.

The NCUA will not conduct an ACET maturity assessment of those credit unions that have $100 million or less in assets. Beginning in 2020, such smaller credit unions will be able use the ACET maturity assessment to conduct a self-assessment. In addition, examiners will emphasize the effectiveness of critical security controls when examining smaller credit unions. The ACET will be available for download on our website.

Of note, our efforts to collect baseline and benchmark data on credit unions using the ACET maturity assessment have not been used in an enforcement capacity. In the event that a safety or soundness issue is identified, examiners are trained to stop the maturity assessment and then proceed with the associated examination procedures for the Gramm-Leach-Bliley Act that are incorporated into Part 748 of the NCUA's regulations.

Information Security Examination Program

In the spirit of examination harmonization, the NCUA is in the process of updating our cybersecurity examination capabilities by leveraging the Information Technology Risk Examination (InTREx) solution utilized by the Federal Deposit Insurance Corporation, the Federal Reserve System, and the State Liaison Committee members of the Federal Financial Institutions Examination Council.[8]

Similar to the tailored work required on the FFIEC's Cybersecurity Assessment Tool, the NCUA is ensuring that our smallest institutions can have their cybersecurity posture examined without undue burden given their respective size and complexities. The InTREx solution is structured in accordance with the Uniform Rating System for Information Technology (URSIT), which focuses on a core module for audit, management, development and acquisition, and support and delivery. It also contains an escalated expanded module that has additional considerations.

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[7] Scheduled examinations and contacts are not done for all credit unions every year. Therefore, each year's demographic focus also includes any institution of the previous demographic that did not have a maturity assessment conducted (for example, in 2019, institutions of $1 billion or more in assets scheduled for examinations that were not conducted in 2018 will be subject to an ACET maturity assessment.

[8] See InTREx, https://www.fdic.gov/news/news/financial/2016/fil16043.html

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The NCUA's new examination procedures described in Part 748 will be housed in our new Modern Examination and Risk Identification Tool (MERIT), which is being piloted through 2020 with full implementation scheduled for 2021.[9] The first phase of the InTREx pilot will focus on statements and questions, examination procedures, and associated job aids. The second phase will be the execution within MERIT.

Future discovery activities are also underway for the full adoption of the URSIT to ensure consistency within our cybersecurity risk ratings and appropriate weighting for IT and cybersecurity risk within the more traditional aspects of financial services.

Awareness, Training and Education Program

In accordance with the National Institute of Standards and Technology (NIST) National Initiative for Cybersecurity Education (NICE) Framework, we are enhancing our training for the following examiner roles:[10]

- Entry-level financial examiners;
- Seasoned financial examiners;
- Subject matter examiners with additional responsibilities unique to IT and cybersecurity; and
- Specialist [Information System Officers] dedicated to IT and cybersecurity.

The role-based training will emphasize the importance of critical security controls and IT service management and delivery, among other categories. The NCUA will focus on providing all agency examiners progressive training to ensure they have a common understanding of the importance of cybersecurity management, vulnerability assessments, and management specialty areas, with other specialty fields to follow.

Quality Assurance and Continual Service Improvement

To continuously review and evolve the cybersecurity examination programs effectiveness, the agency's Office of Examination and Insurance reviews the final examinations of all of our largest consumer and corporate credit unions, as well as the annual sample set of consumer credit union examinations conducted by the NCUA's regional staff. This provides a full lifecycle review on the program, analysis and help with the identification of trends. This process informs plans of action and milestones for improvements more broadly.

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[9] See MERIT, https://www.ncua.gov/regulation-supervision/examination-modernization-initiatives/enterprise-solution-modernization-program/ncua-connect-merit
[10] See NICE Framework, https://www.nist.gov/itl/applied-cybersecurity/nice/nice-cybersecurity-workforce-framework-resource-center.

Going forward, the NCUA is strengthening our review process to map more specifically with a set of NIST Cybersecurity Framework Key Performance Indicators, Key Risk Indicators, and their associated metrics.

Risk/Threat Profile Management

The NCUA is enhancing the collection of information on cybersecurity threats and risks to ensure we obtain and analyze actionable data and collaborate with the credit union industry to the fullest extent possible. We are doing this by distilling trends and tactics used by hostile actors into generic root causes. These root causes are typically in the form of critical security controls and they allow us to begin identifying the critical security controls that contribute to an array of nefarious activities. We can then develop best practice resources credit unions can use to combat the threat of cyberattacks.

Incident Management

Rapid detection and response within a credit union's incident management capabilities is an important root-cause security control. Part 748 of the NCUA's regulations require credit unions to report catastrophic events, including cybersecurity incidents, to their respective NCUA Regional Offices. The NCUA analyzes these reports for follow-on actions and to identify trends.

To improve our data collection and analysis, we are also developing an incident management system in partnership with our Office of the Chief Information Officer's Computer Security Incident Response Team.

Cybersecurity Exercise Management

The NCUA's primary initiative resulting from our relationship with the Financial Services Sector Specific Agency, U.S. Department of Treasury, the Financial Services Information Sharing Analysis and Center, and the National Credit Union Information Sharing and Analysis Organization is the agency's cybersecurity exercise management.

We consider our exercise program to be an extension of our awareness, training, and education program. Here, we focus on designing, developing, conducting, and evaluating exercises so the agency and the credit union industry can improve their resilience or the ability to prepare for, respond to, manage, and recover from adverse events as expeditiously as possible.

Special Projects and Initiatives

In support of the identified priorities and programmatic goals and objectives, the NCUA will engage in a variety of special projects and initiatives to promote cyber preparedness within the credit union industry further. Some primary special projects and initiatives include:

- Monthly cybersecurity articles;
- Hosting cybersecurity forums;
- Hosting a national tabletop exercise;
- Enhancing our cybersecurity resource website; and
- Participating in an array of credit union-sponsored speaking engagements, workshops, and other outreach activities

Recent NCUA Rulemakings

I believe that the NCUA Board is obligated to consider the compliance burdens and the costs our institutions shoulder on a day-to-day basis. As a result, we are reducing, streamlining, and eliminating outdated or overly burdensome regulations where possible, so credit unions can simultaneously stay competitive in the changing environment and continue to provide financial services to their members and communities. We continue to improve the regulatory environment for credit unions without sacrificing our safety and soundness mission.

Bylaw Modernization

In September, the NCUA Board issued a final rule to update, clarify, and simplify the federal credit union bylaws. This final rule reflects an extensive, collaborative effort with the credit union industry dating back to 2013.

The rule was designed to clarify and update the bylaws and to provide significant flexibility in governance, balanced by the consideration of member rights and engagement. Because credit unions are member-owned cooperatives, it is important for us to get the bylaws right. They set the basic qualifications for, among other things, membership, member meeting requirements, the processes credit unions have to follow to protect member voting rights and election procedures, how bylaws and charter amendments may be adopted, and field-of-membership requirements.

One of the more significant changes we made to modernize the bylaws was to permit federal credit unions to conduct hybrid annual and special meetings. This change will be especially beneficial to federal credit unions that serve active-duty members of the armed forces who are serving our country throughout the world and who may be unable to participate in credit union meetings without virtual access. Allowing members to participate virtually, in addition to in-person meetings, has the potential to expand member engagement greatly.

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We also wanted to support federal credit unions in their succession planning efforts. Credit union boards of directors are almost entirely composed of volunteers who are elected to these positions by their fellow credit union members. Succession planning in this context is extremely important, especially for smaller credit unions. To help federal credit unions maintain leadership continuity and create a pipeline of knowledge among their members, the final rule clarified that a federal credit union may establish associate director positions. These positions provide people with an opportunity to gain exposure to board meetings and discussions without formal director responsibilities. This is an important way for credit unions to increase their pool of potential board members.

Finally, we clarified that notices for events, such as annual and special meetings and elections, could be combined with regular communications from federal credit unions to their members. For example, under the new bylaws, a credit union is permitted to send a notice about the nomination process along with monthly or quarterly statements in the same mailing.

Public Unit and Nonmember Shares

This year, the NCUA Board also finalized a rule that raised the threshold on the amount of public unit and nonmember shares a federally insured credit union can receive. The rule delivers on the goals of extending responsible regulatory relief and giving greater flexibility to eligible credit unions to determine the funding structure most appropriate to support their operations.

Public unit and nonmember shares are the functional equivalent of, and no more volatile than, borrowings and, therefore, warrant a higher level of authority than the previous regulation allowed. Setting a higher, but prudent, limit on the amount of public unit and nonmember shares eliminates the need for credit unions to seek a waiver of the limit, as they had to do under the prior rule. This will save credit unions and the NCUA's regional offices valuable time and resources, and will eliminate onerous paperwork without sacrificing safety and soundness.

Most credit unions, however, will be constrained in the amount of leverage they can add to their balance sheets based on their respective levels of net worth. Many small credit unions have net worth levels high enough to take full advantage of this proposed new authority. So, while this final rule provides relief to all federally insured credit unions, it will likely benefit small and low-income-designated credit unions the most.

This final rule will provide individual credit unions with additional flexibility regarding funding options, but it will not materially increase the aggregate level of public unit and nonmember shares and borrowings the credit union system can collectively utilize. Federally insured credit unions currently have about $70 billion in outstanding public unit, nonmember shares, and borrowings, representing 4.5 percent of total assets.

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In doing our research for the rule, we looked back on the overall trends for credit unions, and I'm pleased to say the industry has enjoyed solid share growth, a reflection of its financial strength and the high-quality service credit unions provide. Loan growth over the last several years has been very strong, also reflecting the value of credit unions to consumers, and has consistently outpaced share growth. However, this trend can create liquidity risk for some credit unions.

Our supervisory efforts will continue to keep a watchful eye on liquidity strength and include a more holistic view of credit unions' funding strategies, and this includes those utilizing public unit and nonmember shares as part of the mix. The final rule updates the regulations to recognize the significant changes the credit union industry has undergone in the 31 years since the original limit was adopted, including credit unions' growing need for diversified sources of funding to serve their members.

Commercial Real Estate Appraisals

As we continuously look for ways to rethink regulatory policies that could stand in the way of productive borrowing and lending to credit union members, particularly those in underserved areas — and this includes rural communities — I would like to bring to your attention a number of other rulemakings the agency has finalized this year to help credit unions serve their members better.

This past July, the NCUA Board approved a final rule to update the agency's commercial real estate appraisal standards for credit unions, raising the commercial real estate threshold from $250,000 to $1 million. This rulemaking also amended the agency's regulations to formally include the rural exemption for residential appraisals provided by the Economic Growth, Regulatory Relief, and Consumer Protection Act, or S.2155.

This particular regulatory relief matters to our communities right now. There are areas in the country that experience a scarcity of certified property appraisers. For example, some communities in the rural Midwest do not have a sufficient number of appraisers, which means the process of getting a loan to buy commercial property can get extended many weeks to enable time for a certified appraiser from another region to travel to the borrower's location and provide the necessary physical inspection and estimate of the property's value. This delay can mean significant cost, which has a material adverse impact on lenders and borrowers alike.

The agency conducted comparative analysis and due diligence to determine if raising the appraisal threshold would represent an undue risk to credit union lenders and the Share Insurance Fund. Importantly, we concluded that establishing a new threshold at $1 million does not. I want to be clear on this point. I would not move forward with a regulation that didn't adequately address safety and soundness. In addition, this only applies to real estate transactions, not to loans for other types of business assets.

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Commercial lending represents a relatively small proportion of credit union assets, so these loans are not likely to be a source of undue risk to the Share Insurance Fund. Moreover, credit unions will still be responsible for adhering to the appropriate risk-management practices for underwriting commercial real estate loans, including use of written estimates of market value conducted by a qualified person independent of the transaction, such as a licensed appraiser. That is a critically important part of keeping faith with the borrowers, members, and the communities these institutions serve.

We took great care to listen to both the supporters of raising the appraisal threshold and to its critics. We considered their perspectives and weighed their concerns carefully in crafting this rule. I am confident that the final regulation is prudent and that it will facilitate lending while ensuring the safety and soundness of the financial institutions under our watch. At the same time, we instituted a number of additional safeguards to mitigate any concerns about the increased risk in these transactions. The higher appraisal threshold will be met with enhanced standards for written estimates of market value containing sufficient information to support the credit decision. These assessments will be conducted by independent and qualified professionals. This rule also allows credit unions to catch up with banks, whose qualified business loan threshold for appraisals has been at $1 million since 1994.

And, just last month we issued a proposed rule, which is currently out for public comment, to raise our residential real estate appraisal threshold from $250,000 to $400,000. Consistent with safe and sound banking practices and with the requirement for other transactions that fall below applicable appraisal thresholds, the proposed rule would require credit unions to obtain a written estimate of market value of the real property collateral in lieu of an appraisal.

We recently strengthened the regulatory standards for written estimates of market value by codifying independence requirements for persons conducting this type of valuation, and these individuals must be qualified and experienced to conduct such valuations. Raising the residential real estate appraisal threshold would bring us into alignment with the banking regulators, who raised their threshold earlier this year.

Field of Membership

The agency revived its rulemaking in the field-of-membership area, work that dates back to 2015 and 2016. On October 24, 2019, the NCUA Board unanimously approved a proposed rule to better explain its decision to eliminate the core area requirement, emphasizing that such a decision would increase flexibility to applicants for community charters, and, thus, increase the likelihood of providing financial services for low- and moderate-income individuals. The Board also re-proposed the combined statistical area provision. With this proposed rule, the agency took a critical step in the NCUA's ongoing work to allow credit unions to alleviate some of the difficulties low-income and underserved Americans face in accessing financial services.

Payday Alternatives

Today, one of the many ways that credit unions fulfill their mission is by offering Payday Alternative Loans (PALs). While many credit unions offer some type of safer small-dollar loan product to their members, in 2010, the NCUA began authorizing a unique PALs program for federal credit unions. These loans have fewer fees and are offered at low rates capped at 28 percent, which is nothing close to the triple-digit rates charged by online and storefront payday lenders. Furthermore, as member-owned, not-for-profit financial cooperatives, credit unions play a key role in investing in their members' financial futures. They provide access to financial education, the possibility of establishing savings, and other services to ensure their members are on a pathway to financial stability. In fact, more than 80 percent of federal credit unions offering PALs report payments to credit bureaus, a critical step towards borrowers building access to mainstream financial services and breaking the cycle of debt.

At the end of 2018, 502 federal credit unions reported that they made payday alternative loans during the year. These credit unions reported making 211,574 loans amounting to $145.2 million during the year. In comparison, in 2012, 476 federal credit unions reported that they made 115,809 loans amounting to $72.6 million.

Earlier this year, the NCUA Board expanded the PALs program to give federal credit unions additional flexibility to offer their members meaningful alternatives to traditional payday loans while maintaining many of the key structural safeguards of the original PALs program. Known as PALs II, this new option is not intended to replace the current PALs program. Rather, it will be another option, with different terms and conditions, for federal credit unions to offer PALs to their members. PALs II incorporates many of the structural features of the original PALs program designed to protect borrowers from predatory payday lending practices. Those features include a limitation on rollovers, a requirement that each PALs II loan must fully amortize over the life of the loan, and a limitation on the permissible fees that a federal credit union may charge a borrower related to a PALs II loan. A federal credit union would also have to structure each loan as closed-end consumer credit. New or modified features unique to PALs II loans include: loan amount, loan term, membership requirement, number of loans, and a restriction on overdraft fees.

The original PALs program requires a borrower to be a member of a federal credit union for at least one month before the credit union can make a PALs loan to that borrower. The PALs II program does not have this minimum membership requirement. The purpose of this change was to allow a federal credit union to make a PALs II loan to any member borrower who needs access to funds immediately and would otherwise turn to a payday lender to meet that need. This is a better alternative than having those borrowers take out predatory payday loans and wait for 30 days before rolling that predatory payday loan over into a PALs II loan, or worse, never applying for a PALs II

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loan. However, credit unions will be free to require a minimum length of membership for their PALs II loans if they so choose.

In contrast to the original PALs program, there is no minimum loan amount under the PALs II program, because it may not be prudent for a federal credit union to require a member to borrow more than necessary to meet their demand for funds. Establishing a minimum PALs II loan amount could require a borrower to carry a larger balance and incur additional interest charges when a smaller PALs II loan would satisfy that borrower's need for funds without the additional interest charges. The $2,000 maximum loan amount for PALs II loans is double the amount allowed under the original program and is designed to give a federal credit union the opportunity to meet increased demand for higher loan amounts from payday loan borrowers. It also provides some borrowers with an opportunity to consolidate multiple payday loans into one PALs II loan and a means for creating a pathway to mainstream financial products and services offered by credit unions.

While the original PALs program limited loan maturities to a minimum of one month and a maximum of six months, the PALs II program allows a federal credit union to make a loan with a minimum maturity of one month and a maximum maturity of 12 months. The longer loan term will allow a federal credit union making a PALs II loan to establish a repayment schedule that is affordable for the borrower while still fully amortizing the loan.

PALs II is a reflection of our experience overseeing the original PALs program and of working with consumer-focused organizations to craft financial solutions that make a difference to millions of Americans with low to moderate incomes. PALs is a program of prudent lending that directly helps households who have to date been relegated to the high interest rate, subprime payday lending industry. The NCUA is committed to building on our experience in this area and adjusting this program in a way that helps credit unions maximize sustainable and affordable service to their members.

Diversity and Inclusion

I have described financial inclusion as the civil rights issue of our era. By "inclusion," I mean not only broader access to affordable financial services, but also to employment and business opportunities. Our country is going through a period of profound demographic change, and our financial system should be leading efforts to respond to that change. Credit unions are growing stronger, and they serve their members and communities better when they promote greater diversity, equity, and inclusion as part of their business model. The NCUA complies with every component of Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

With respect to diversity within credit unions, the NCUA issues an annual voluntary self-assessment for credit unions to assess diversity and inclusion within their

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organizations. As the regulator, we model for the industry that diversity, equity, and inclusion are strategic imperatives. All three of the agency's board members continuously promote the value of these principles within the industry. We were the first among the financial regulators to issue the self-assessment tool. We are currently in our fourth year of collecting submissions from the industry. We strongly encourage credit unions to assess their diversity and inclusion policies and practices through the NCUA's Credit Union Diversity Self-Assessment. For example, we recently hosted an industry-specific diversity, equity, and inclusion summit to provide best practices and promote the value of diversity to the industry. We have committed to hosting such an event annually in different locations to promote greater opportunities for stakeholder participation.

The agency already provides guidance to the industry on supplier diversity and we will be issuing a guide on boardroom diversity. As Chairman of the Board, I have sent letters to all federally insured credit union CEOs expressing the NCUA's commitment to diversity, equity and inclusion and asking for their participation in the credit union diversity self-assessment. Similar communications have also been sent to all credit union leagues, asking them to encourage their members to submit the self-assessment.

The agency has taken the position of going beyond just assessing and setting standards for the industry. We are actively promoting the principles of diversity, equity, and inclusion, including providing guidance and sharing best practices.

In terms of supplier diversity, the NCUA has integrated supplier diversity principles into our own procurement process. As a result, we have grown from 6 percent in awarded contract dollars to minority- and women-owned businesses in 2010 to 45 percent in 2018.

With respect to workforce diversity and inclusion at the NCUA, we have a robust and comprehensive program that has allowed the agency to make improvements in the demographics of our entire workforce, including at the senior leadership level. As of the pay period ending on March 16, 2019, the NCUA workforce composition was as follows:

- The total NCUA workforce count was 1,120.
- Males made up 631, or 56.3 percent, of the total NCUA workforce.
- Females made up 489, or 43.7, percent of the total NCUA workforce.
- Minorities made up 333, or 29.7, percent of the total NCUA workforce.
- The NCUA senior leadership team was 46 percent female.
- The NCUA senior leadership team was 22 percent minority.

Our assessment of our diversity and inclusion initiatives is an ongoing process and one we continually seek to develop and improve.

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Second Chance Initiative

Another initiative the Board undertook in the diversity, equity, and inclusion space earlier this year, and one which I consider to be one of our most important Board actions, involves extending "second chance" opportunities to job applicants with old criminal records for minor, non-violent offenses. It is hard to estimate accurately the number of Americans with criminal records, but one commonly cited number is 70 million. A great many of these Americans face barriers to hiring that leave them unemployed or underemployed. Fortunately, policymakers and corporate leaders have begun to rethink these punitive hiring practices and the financial services industry can and should play a leading role in welcoming these individuals back into the mainstream of American life.

The NCUA Board is making a concerted effort to provide second chances where we can.

Since I became Chairman, we approved an employment waiver for a woman who has a criminal record. But, she paid her debt to society, rehabilitated herself, and has no further history of criminal behavior. A drug addiction from nearly 25 years ago will not hold her back from working for a federally insured credit union.

On a broader policy level, the Board recently updated the agency's Interpretive Ruling and Policy Statement regarding statutory prohibitions on persons who have been convicted of any criminal offense involving dishonesty or breach of trust or who have entered into pretrial diversion or similar programs in connection with a prosecution for such offenses. Previously, such a person could not participate in the affairs of an insured credit union except with the prior written consent of the Board. By amending our guidance, we are reducing the scope and number of offenses that would require an application to the Board. Specifically, credit unions would not have to get prior Board approval to hire someone who, as a young adult, committed such violations as small-dollar theft, false identification, simple drug possession, and other isolated minor offenses.

My primary responsibility is the industry's safety and soundness. But, where appropriate, I want to encourage the financial services industry to take reform-minded steps that better meet the needs of the communities and citizens we serve.

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Minority Depository Institutions

Another initiative we have developed to make it easier for credit unions to serve members of modest means and those in underserved areas is our minority depository institution (MDI) preservation program, through which we provide technical assistance, training, and mentoring opportunities to help MDI credit unions help their members.

Credit unions are by design different from other financial institutions. They are member-owned-and-controlled, not-for-profit, cooperative entities. Their boards of directors are made up of volunteers. Their central mission is to give groups of people access to affordable financial services and the ability to participate in their institutions' management.

MDI credit unions, more particularly, serve the financial needs of racial minorities because such populations traditionally have been underserved by the financial system. A credit union's designation as an MDI is defined by the minority composition of its current and potential membership and the minority composition of its board of director, consistent with the definition set forth in Section 308 of The Financial Institutions Reform, Recovery, and Enforcement Act of 1989.

The NCUA understands the significant value these credit unions represent to their members and communities, and recognizes the challenges they face. There are many benefits to having a diverse and inclusive financial services sector. It makes sense to have board members, managers, senior leaders, and employees reflect the community a financial institution serves. Diversity leads to better service, greater innovation, improved solutions and a larger customer or membership base. This is why the NCUA is committed to supporting MDIs and the communities they serve.

As of June 30, 2019, there are 526 federally insured credit unions designated as MDIs. Collectively, MDI credit unions serve 3.9 million members, manage $39.6 billion in assets, hold aggregate deposits of $34 billion, and own $27.5 billion in loans.

Earlier this year, the NCUA created a new pilot mentoring program for small low-income credit unions that are also designated as MDIs. I'm delighted we could help these small credit unions establish relationships with larger institutions to help them grow and thrive.

Diversity, Equity, and Inclusion Summit

Last month, the NCUA hosted its first Credit Union Diversity, Equity, and Inclusion Summit, bringing together industry leaders, regulators, and policy experts for a daylong series of conversations focused on what the credit union industry can do to better advance our commitment to a financial system that works for everyone. For too long, too many people have been overlooked or locked out of the financial mainstream. We

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know that the lack of access to affordable financial services holds working families back from taking that next step up the financial ladder. We need to remove the obstacles to financial security these Americans are facing.

Guidance on Serving Legal Hemp Businesses

One area I want to highlight, because of recent Congressional action in this space and ongoing Congressional interest, is the legalization of hemp as part of the Agricultural Improvement Act of 2018. Since the enactment of the law, we have been proactive in making sure that credit unions are aware that the law removed hemp from the Controlled Substances Act and the framework Congress has created for the U.S. Department of Agriculture (USDA) to regulate domestic hemp production.

We expect to continue updating the credit union community now that the USDA has published its interim final rule. We have received interest from credit unions eager to know the rules of the road for serving hemp-related businesses in their communities, and we want to make sure those credit unions have what they need to make informed decisions in this area.

Some credit unions have lawfully operating hemp businesses within their fields of membership. Businesses dealing with hemp and hemp-derived products include manufacturing, distribution, shipping, and retail companies, among others. With the recent changes in federal law, more hemp-related businesses may be founded, and existing ones expanded. Growth in hemp-related commerce could provide new economic opportunities for some communities and will create a need for such businesses to be able to access capital and financial services. In turn, we continue to advise credit unions that they must be aware of the federal, state, and Indian tribal laws and regulations that apply to any hemp-related businesses they serve, and they need to understand the complexities and risks involved. We are advising credit unions that they must continue to have Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) compliance programs commensurate with the level of risk and complexity involved in the services and accounts they offer.

Many credit unions have a long and successful history of providing services to the agriculture sector. Hemp provides new opportunities for agricultural communities. The NCUA is encouraging credit unions to thoughtfully consider whether they are able to safely and properly serve lawfully operating hemp-related businesses within their fields of membership, and we stand ready to work with them.

Merger and Acquisition Activity

The declining number of federally insured credit unions reflects a long-term trend of consolidation within the financial services industry overall. The vast majority of credit union merger activity is voluntary, with credit unions citing economies of scale, the ability to offer relevant online banking services, and succession planning as the top reasons for mergers. However, each year, a relatively small number of institutions are merged or acquired at a cost to the Share Insurance Fund. Seven federally insured credit unions that were merged or acquired in 2018 required assistance from the Share Insurance Fund.

Bank Secrecy Act/Anti-Money Laundering

NCUA conducts a BSA/AML review during every examination and takes appropriate action when necessary to ensure our regulated financial institutions meet their obligations under applicable BSA/AML regulations.

The NCUA continues to partner with fellow federal financial regulators, Treasury, and the Financial Crimes Enforcement Network (FinCEN), to improve transparency, efficiency and effectiveness of the BSA/AML regime in the United States. This partnership includes outreach to all industry stakeholders and continued work streams by agency staff, along with our partners at the other federal financial regulatory agencies and Treasury, to continue improving transparency, clarity, and effectiveness while seeking ways to reduce burden and increase efficiency.

In October 2018, the NCUA joined other federal agencies in issuing a joint statement addressing improved efficiency through shared resources and collaborative relationships. The statement outlines ways in which institutions with limited BSA risk can share resources with other similar institutions, thereby lowering costs while in many cases improving effectiveness and efficiency. It addresses instances in which these institutions might decide to enter into collaborative arrangements to share resources to manage their BSA/AML obligations more efficiently and effectively. The costs of meeting BSA/AML requirements and effectively managing the risk that illicit finance poses to the broader U.S. financial system may be reduced through sharing employees or other resources in a collaborative arrangement with one or more other credit unions or banks. These arrangements may also provide access to specialized expertise that individual institutions may otherwise be challenged to acquire without the collaboration. This may benefit some credit unions, especially smaller institutions that may find hiring or retaining staff with the necessary knowledge a challenge.

In July of this year, the agencies issued a joint statement clarifying the consistent risk-focused approach used by the federal financial regulators, including the NCUA, during examinations. The statement helps regulated financial institutions better understand what they can expect during a BSA/AML examination as well as clarifying that the agencies tailor each examination to the unique characteristics and risk indicators that exist at each institution. It outlines common practices for assessing an institution's money laundering/terrorist financing risk profile, assisting examiners in scoping and

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planning the examination, and evaluating initially the adequacy of the BSA/AML compliance program. Using this approach, the agencies generally are able to allocate more resources to higher-risk areas and fewer resources to lower-risk areas when conducting BSA/AML examinations. This risk focus ensures meaningful examinations scaled up or down based on the risk presented by each unique institution.

The NCUA is also working closely with our partner agencies to revise and update the BSA/AML examination manual to clarify expectations for examiners. FFIEC agencies and Treasury are working diligently to ensure examiners appropriately apply a risk-focused examination consistently.

Finally, I meet monthly with my federal counterparts to closely monitor and provide direction to agency staff on priorities and initiatives designed to improve transparency, efficiency and, most importantly, the effectiveness of the BSA/AML regime in the United States.

Financial Technology Updates

While financial innovation holds promise, it is crucial that credit unions, consumers, and other stakeholders understand and mitigate associated risks. The NCUA's goal is to balance maintaining the safety and soundness of credit unions without stifling their use of innovative technology and related vendors. Credit unions need to embrace financial technology while also clearly understanding and managing any risks they may incur.

My top priorities with respect to fintech include outreach and education. The NCUA's Fintech Working Group is looking at ways federally insured credit unions can adopt and embrace fintech so they can compete in the changing financial services industry effectively. The agency will continue to solicit industry feedback about the competitive issues credit unions face, and the industry is collaborating with marketplace lenders and other fintech companies.

The NCUA will continue to promote technical assistance programs that low-income credit unions can use to support the acquisition and development of fintech-related digital services. I am also interested in exploring opportunities to partner with academic institutions to continue to research and monitor financial technology—such as online lenders, machine learning, artificial intelligence, and payment systems—to identify the benefits to consumers, especially those that are underserved and how fintech may affect credit unions.

The NCUA is actively coordinating on fintech issues with the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Consumer Financial Protection Bureau. The agency will continue to participate in interagency working groups and discussion forums, and any other opportunities for coordination.

Thank you for the opportunity to provide an update on the strong state of the credit union industry and to highlight NCUA's latest initiatives. I look forward to your questions.

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

Q.1. In November 2019, the Federal Reserve issued a report on bank branch access in rural communities.[1] The report found that most rural counties experienced a significant decline in bank branches between 2012 and 2017, but small businesses and certain consumers prefer using local banks and cannot find comparable financial products and services elsewhere. How does the decline in bank branches or loss of all banks in a community affect the local economy? What policy steps will the Federal Reserve take to address the decline in bank branches? How did this analysis affect the Board's decision on the BB&T–SunTrust merger that will result in more branch closures?

[1] *https://www.federalreserve.gov/publications/files/bank-branch-access-in-rural-communities.pdf.*

A.1. As noted in the report, the takeaways from the listening sessions indicated that the loss of a bank branch in a community appears to have a community-level effect that goes beyond the effects on particular individuals or businesses. Examples of such effects included declines in access to local financial advice, loss of important civic leadership, and the loss of a banker's personal touch. Research cited in the report also noted that when local bank branches close there is a negative effect on access to credit for local small businesses. To the extent that this decrease in credit access causes those businesses to reduce their overall level of economic activity, such a bank branch closure could have a corresponding negative effect on the local economy. Further research would be needed to assess the economic impacts of the loss of branches on local communities.

As with all merger applications, the Federal Reserve Board (Board) considered comments on the proposal from the public, including comments expressing concerns that the proposal could result in branch consolidations and closures. The Board's analysis with respect to these comments is detailed in the Board's order.[1]

Q.2.a. Recently, the Federal Reserve approved the merger of BB&T and SunTrust—two institutions with a significant overlapping branch footprint. Many commenters on the application expressed concern that the proposal would result in branch consolidations and closures, which could negatively affect LMI and rural communities. The Federal Reserve's Order Approving the Merger states that BB&T has committed that Truist Bank would not have any merger-related branch closures for 1 year and would not have any merger-related branch closures in rural areas with populations under 2,500 for 3 years following consummation of the merger. BB&T also represented that Truist Bank would seek to open at

[1] FRB Order No. 2019–16, pgs. 29–53 (November 19, 2019).

least 15 new branches throughout its footprint in LMI and/or majority-minority census tracts through 2022.

- How does the Federal Reserve plan to enforce these commitments and representations? Will Truist be subject to any similar restrictions after 2022? Will the Federal Reserve reject any application to close a branch submitted by Truist Bank under these parameters? Will the Federal Reserve take action against Truist Bank if it does not open at least 15 new branches in LMI and majority-minority census tracts?

A.2.a. Truist Bank is a State nonmember bank supervised by the Federal Deposit Insurance Corporation (FDIC), so the appropriate Federal supervisory agency for purposes of the branch closure requirements and Community Reinvestment Act examination is the FDIC.

Q.2.b. In addition, please provide a list of the rural areas with populations under 2,500 described in the Order.

A.2.b. As indicated, BB&T represented that it will not close branches within rural communities of 2,500 or fewer persons, as determined by the U.S. Census Bureau, for 3 years. The Federal Reserve has not compiled a list of all such communities in the Truist service area. Any branch that Truist proposes to close in the future can be evaluated at that time to determine whether it is in keeping with the commitment. See Appendix A.

Appendix A: Response to Question 2 from Ranking Member Sherrod Brown

Truist Branch Offices Located in Population Centers of 2,500 Persons or Less

	State	Area	Offices
1	Virginia	Cheriton	1
2	Virginia	Doswell	1
3	Virginia	New Market	1
4	Virginia	Onancock	1
5	Virginia	Patrick County	1
6	Virginia	Smith Mountain Lake	1
7	Virginia	Charlottesville Area	8
8	Virginia	Dulles	1
9	Virginia	Eastern Shore	3
10	Virginia	Greater Richmond	1
11	Virginia	Mid-Valley	3
12	Virginia	Northern Valley	3
13	Virginia	Peninsula	4
14	Virginia	South Central	4
15	Virginia	Southwest	14
16	Virginia	Tri-Cities	1
17	Virginia	Virginia Beach	1
18	North Carolina	Asheville	1
19	North Carolina	Boone	1
20	North Carolina	Chattanooga	1
21	North Carolina	Coastal Lakes	4
22	North Carolina	Cumberland/Sampson	2
23	North Carolina	Four Counties	1
24	North Carolina	Greater Wilmington	1
25	North Carolina	Onslow Duplin Counties	2
26	North Carolina	Randolph County	1
27	North Carolina	Roanoke Rapids	3
28	North Carolina	Roanoke River Area	1
29	North Carolina	Sandhills	3
30	North Carolina	Smithfield	1
31	North Carolina	Sparta	1
32	North Carolina	Surry County	2
33	North Carolina	Warrenton	2
34	North Carolina	Wilson	1
35	Pennsylvania	Berks/Schuykill	2
36	Pennsylvania	Chester City/Delaware City	1
37	Pennsylvania	Lancaster	1
38	Pennsylvania	Lehigh Valley	1
39	Pennsylvania	York	6
40	Georgia	Lake Oconee	1
41	Georgia	Athens	2
42	Georgia	Chattanooga	1
43	Georgia	Gainesville	1
44	Georgia	NCA-Greensboro-Lake Oconee	1
45	Georgia	South Atlanta	1
46	Georgia	Warner Robbins/Tifton	1
47	Maryland	Charlotte Hall	1
48	Maryland	Green Valley	1
49	Maryland	Annapolis North Shore	2
50	Maryland	Carroll County	1
51	Maryland	Carteret	1
52	Maryland	Harford County	1
53	Maryland	Western	2
54	South Carolina	Charleston	1
55	South Carolina	Columbia	2
56	South Carolina	Loris	1
57	South Carolina	Lowlands	1
58	South Carolina	McCormick	1
59	South Carolina	St. Matthews	1
60	West Virginia	Charleston/Parkersburg	2
61	West Virginia	Southern	1
62	West Virginia	Wheeling/Martinsburg	4
63	Kentucky	Greater Lexington	2
64	Kentucky	Northern Kentucky	2
65	Kentucky	Owensboro	2
66	Tennessee	Joelton	1
67	Tennessee	Chattanooga	2
68	Tennessee	Greater Knoxville	2
69	Alabama	Greater Birmingham	2
70	Alabama	Montgomery	1
71	Florida	Marianna	1
72	Florida	Pine Island	1
73	Florida	Polk	1
74	Texas	East Dallas-Fort Worth	1

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

Q.1. The U.S. regulatory agencies with jurisdiction over the Volcker Rule (the "Volcker Agencies") have long recognized the problems under the covered funds provisions for so-called "foreign excluded funds." Specifically, these funds that are not "covered funds" under the Volcker Rule because they are organized and operated outside the United States by a Foreign Banking Organization. However, foreign exempt funds are treated as banking entities to the extent they are controlled by a bank subject to the Volcker Rule. The Volcker Agencies have taken several steps, through FAQs and time-limited relief, to address this issue. In the July 2019 final rulemaking, the Volcker Agencies state that they are considering how to more permanently address the treatment of foreign excluded funds as part of the ongoing covered fund proposal and rulemaking.

Q.1.a. Therefore, as part of any forthcoming proposal on Volcker Covered Funds, will you provide relief for "foreign excluded funds" on a permanent basis?

A.1.a. On January 30, 2020, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Agency, the Office of the Comptroller of the Currency, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (the Agencies) jointly issued a notice of proposed rulemaking (NPR)[1] addressing the covered funds provisions of the Volcker Rule regulations. The NPR, which was developed jointly by the Agencies, includes provisions that would give banking entities increased flexibility to invest in and sponsor venture capital funds and funds that extend credit.

Q.1.b. Additionally, it is known that the prohibition of bank investment into venture capital funds has reduced the amount of capital available to American entrepreneurs and resulted in a disproportionate impact on communities located outside of Silicon Valley and other traditional tech hubs. It has also considerably hurt GDP and investment.

Q.1.c. Should venture capital be included in the definition of a "covered fund"?

A.1.a.–c. The January 30, 2020, NPR includes provisions that would give banking entities increased flexibility to invest in and sponsor venture capital funds. The Agencies welcome public comment on the NPR, including potential effects on startup investment and economic impact.

Q.1.d. Is the Fed considering startup investment and economic impact during this reform process?

A.1.d. Please see the response to question 1.c.

Q.2. In 2014, Congress passed and the President signed the Insurance Capital Standards Clarification Act of 2014 (S. 2270) that amended section 171 of the Dodd-Frank Act to permit the Fed to create a tailored nonbank centric capital regime for Fed supervised

[1] See *https://www.federalreserve.gov/aboutthefed/boardmeetings/files/volcker-rule-fr-notice-20200130.pdf.*

insurance groups. Under S. 2270, banking activities of insurers are subject to bank capital rules, but the law states that insurance standards should apply to insurance activities. However, the Fed continues to ignore the direction of Congress and the letter of the law and wants to apply a consolidated, bank centric capital requirement on Fed supervised insurance groups (section 171 calculation). The Fed's other group capital standard for Fed supervised insurers, the Building Blocks Approach (BBA), is tailored to the business of insurance.

Q.2.a. Why is the Fed pursuing an additional "section 171 calculation" that will apply in addition to the BBA calculation, when section 171 itself does not require this additional calculation?

Q.2.b. This layering approach increases complexity for no reason or gain and is a drag on economic growth. Please explain how the Fed will act in compliance with the Insurance Capital Standards Clarification Act of 2014.

A.2.a.–b. Section 171 of the Dodd-Frank Act requires the Board to establish minimum risk-based capital requirements for depository institution holding companies on a consolidated basis. The Insurance Capital Standards Clarification Act of 2014 (the Clarification Act) amended section 171 to permit the Board to exclude State-regulated insurers from this consolidated minimum risk-based capital requirement. The Clarification Act, however, does not allow a blanket exemption for an entire holding company structure. In particular, it explicitly does not allow the Federal Reserve to exempt a depository institution holding company from calculating its capital requirements for non-insurance entities in the corporate chain.

In September 2019, the Board issued a proposal on risk-based capital requirements for certain depository institution holding companies significantly engaged in insurance activities (the proposal). The proposal would establish an enterprise-wide risk-based capital framework, known as the Building Block Approach, which is intended to facilitate the assessment of overall risk-based capital adequacy for a depository institution holding company that is significantly engaged in insurance activities by measuring aggregate capital while taking into consideration State insurance capital requirements. The proposal also includes a minimum risk-based capital requirement for the non-insurance entities within the holding company structure required by section 171, as amended by the Clarification Act (section 171 calculation). The section 171 calculation would use the flexibility afforded by the Clarification Act and exclude State-regulated insurers from minimum risk-based capital requirements to the extent permitted by law.

The Board recently invited public comment on all aspects of the proposal, including the section 171 calculation. Consistent with the Administrative Procedure Act, the Board will consider this and other comments before making a final rule.

Q.3. In your testimony before the House Financial Services Committee you stated that the Fed is currently considering how best to implement the remainder of the international Basel III agreement and that the Fed is aware that the impact of implementing Basel III revisions into the U.S. framework may result in "significantly raising the aggregate level of capital in the industry." You also stated that the Fed "regularly looks at the calibration of the G–SIB surcharge and we are considering it in the context of the overall body of regulation." Additionally, Chair McWilliams noted that the Basel Committee conducted a quantitative impact study in 2009 at one of the worst times for banks' balance sheets that included only 14 U.S. banks. Chair McWilliams suggested that she would support an analysis focused on a more specific impact in the United States. I strongly agree that a holistic and comprehensive review of the capital framework in the United States is necessary to ensure that capital levels are calibrated appropriately to maintain a level playing field with our international counterparts, especially given the many post-crisis reforms that we have discussed.

Q.3.a. When does the Fed plan to complete the comprehensive review and publish the results so that they may be made available to lawmakers and to the public?

Q.3.b. If the nature of the review is ongoing and long-term, when can we expect an initial set of findings to be released based on provisions that are currently being implemented?

A.3.a.–b. As noted, I think it is important for the Board to consider the remaining elements of the Basel III framework (especially the operational risk element and the fundamental review of the trading book) as a whole, and then examine that whole in the context of the existing framework. As a number of my colleagues and I have noted, the existing regulatory regime has established a robust level of loss-absorbing capacity for the industry. Thus, if a sensible calibration of these final elements of Basel III would result in a material increase in the industry's aggregate capital level, that could suggest that some of the existing elements may be appropriately re-calibrated to the international norms. We will not be able to make a judgment about whether these final elements of Basel III would materially increase capital levels or, if they do, about which elements of the existing framework (if any) might merit reconsideration until we have done the very detailed work of preparing the regulatory text for all the remaining elements of Basel III, which is a large task.

At the beginning of the year, I had hoped that we might be in a position to propose NPRs for comment on this package of issues by the end of the year—although such a schedule would have been quite aggressive and well in advance of the internationally agreed timetable for implementation of the remaining Basel III measures. That aspirational schedule has now necessarily been delayed by the need to focus staff resources on responding to the economic distress created by Government isolation measures intended to address current public health concerns. As the depth and duration of the Government constraint of the economy remains highly uncertain, I cannot now estimate when I will be able to ask Federal Reserve staff to reengage on the preparation of NPRs for the implementation of Basel III. The Basel Committee itself has extended the internationally agreed implementation timeline by a full 2 years. I do not believe that the U.S. process will need to be delayed this long, and it remains a high priority of mine to resume this process, and complete it as a package for the United States well in advance of the international deadline.

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

Q.1.a. In response to my question Chairman McWilliams noted that the FDIC regulates banks the same way it regulates ILCs. From the FDIC perspective that may be accurate, but ILCs are not subject to regulation or supervision at the parent holding company level. ILCs may be owned by a nonfinancial company not subject to the BHC Act, which introduces important policy questions. In particular, the lack of capital and liquidity standards at the holding company, no real requirements that the holding company act as a source of strength to the ILC, no ongoing supervision or regulation, and no other prudential and risk management standards applied to the holding company can really expose the financial system and Deposit Insurance Fund to risk.

Aside from what the FDIC does, what potential concerns do these regulatory gaps present?

A.1.a. In general, institutions that are similar to one another in function should be subject to similar regulation. When the same economic activity can be conducted through different legal structures subject to different regulatory restrictions, this can create an incentive for risky activities to concentrate in specific parts of the financial system, rather than to be distributed across a variety of institutions with the attendant resilience that such diversity usually promotes. Congress has provided a statutory exemption from the Bank Holding Company Act for industrial loan companies (ILC) which places those institutions outside of the Federal Reserve Board's supervision and regulation. Thus, whether and ILC is subject to substantially similar regulation as a bank holding company (BHC) when they engage in similar activities will be a function of the Federal Deposit Insurance Corporation's (FDIC) oversight of these firms, including any commitments made by the firms to the FDIC as part of the FDIC's approval of the ILC's application for deposit insurance.

Q.1.b. What are some of the supervisory issues that could be left unaddressed if an especially large commercial firm gets access to an ILC charter absent Fed supervision, which is a standard feature for large bank holding companies?

A.1.b. As noted above, whether the relevant activities of an ILC will be subject to substantially similar supervision and regulation as those of a BHC engaged in the same activities will be a function of the FDIC's oversight. There is no inherent reason that the FDIC cannot impose appropriate conditions to the approval of an ILC's application for deposit insurance that would address some of the key disparities that you cite in your letter. Federal Reserve supervision of holding companies is complex, however, and it would be difficult to replicate the regulatory framework fully to create a truly level playing field between BHCs and ILCs.

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

Q.1.a. Montana, and many areas of the country, face challenges of housing availability, affordability, and aging housing stock. As you know, this is a significant issue for rural as well as urban areas and is one of the largest barriers to success nationally. In Montana, lack of workforce housing is one of the greatest inhibitors of economic development.

What can be done to increase workforce housing and encourage more affordable housing to be built?

A.1.a. A wide range of factors and policies outside of the purview of the Federal Reserve Board (Board) affect the availability and affordability of housing in the United States. The Board monitors developments in housing and labor markets to assist in our understanding of the broader economy.

Since 2008, the number of housing units constructed in the United States has remained well below historical averages resulting in a shortage of two million to three million units. Various industry reports cite shortages and rising costs in the factors of production. Regulation also reportedly restricts new construction in many parts of the country and we are aware that many State and local governments are now pursuing various interventions (such as subsidies, land grants, zoning changes, and other incentives) to encourage the production of new housing units.

In light of the evolving impacts of the current public health crisis, the Board is monitoring housing and related conditions through surveys and outreach to gain insight into new challenges that may be arising with regard to building workforce and affordable housing in rural communities.

Q.1.b. What do you see as the largest barrier to affordable housing, particularly in rural areas?

A.1.b. The cost of housing does appear to weigh on the budgets of households living in rural areas. For example, almost half of households that rent in rural areas are "cost-burdened," meaning they spend more than 30 percent of their income on rent.[1] Among owner-occupied households in rural areas, the cost-burdened share is much lower, though home ownership may still feel unaffordable for households with low income, low wealth, or imperfect credit histories. One potential barrier to affordable housing in rural areas is constraints on the production of new housing. For example, construction sector data and various industry reports suggest that construction labor for the country as a whole is in short supply. Regulation or constraints on other construction inputs may also restrict new construction in rural areas. These constraints may be pushing up the cost of housing. Indeed, median gross rent in rural areas increased 64 percent between 2000 and 2017, far more than inflation.[2]

Another barrier to affordable housing is stagnant incomes for many households. Inflation-adjusted median household income among both rural and nonrural households changed little between 2000 and 2017. A variety of factors, many related to developments in the labor market, have weighed on income growth for the typical household. Even if rents in rural areas had not grown as robustly

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[1] *See https://ipums.org.* Calculation from the 2017 American Community Survey. Rural areas are areas that are not in an identifiable metropolitan area, as defined by the Office of Management and Budget.

[2] *Id.* Calculations from the 2000 Census and 2017 American Community Survey.

as they did over the past couple decades, many households likely would have still faced housing affordability pressures due to a lack of income growth.

Preliminary data suggests that employment losses due to the COVID–19-induced economic slowdown have disproportionately affected sectors primarily comprised of low-wage workers, including retail sales and hospitality. We know that workers in these sectors faced significant affordability challenges even prior to the current downturn. We are closely monitoring ongoing changes in employment and housing markets to assess the effects of these developments on overall housing affordability, including with an eye toward understanding new or increasing disparities that may exist for certain vulnerable groups.

Q.1.c. How has the [Fed/FDIC/NCUA] worked to support housing? Where is there room for additional efforts?

A.1.c. Over the last several years, the Board and Reserve Banks have conducted research to help shed light on obstacles in the marketplace, as well as highlight innovative approaches aimed at overcoming roadblocks. Examples of the Board's research into the increasing prevalence of housing affordability issues include staff papers entitled "Rural Affordable Rental Housing: Quantifying Need, Reviewing Recent Federal Support, and Assessing the Use of Low Income Housing Tax Credits in Rural Areas"[3] and "Rental Housing Affordability in the Southeast: Data from the Sixth District."[4] Board economists have also researched the effect of State and local regulatory impediments, as published in a piece entitled "Regulation and Housing Supply."[5] Additionally, the Board has brought together local, State, and national stakeholders to discuss potential causes of, and solutions for addressing, the current high incidence of housing affordability challenges. Furthermore, in light of the impact on household finances related to COVID–19, staff are working to conduct research, field surveys, and engage with a broad cross-section of stakeholders to gain insight into the implications for housing markets.

Q.2. I appreciated the responses to my questions during the hearing, and the focus on supporting our farmers and ranchers and their families through the current challenges facing the agriculture sector while continuing to prioritize the safety and soundness of our community financial institutions.

Is there anything that you would like to add on this topic?

A.2. The Federal Reserve continuously monitors agricultural conditions, loan volumes, and agricultural credit risk indicators as well as how conditions affecting the agriculture sector may impact the banks and bank holding companies we supervise. As conditions

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[3] *See* Dumont, Andrew; Rural Affordable Rental Housing: Quantifying Need, Reviewing Recent Federal Support, and Assessing the Use of Low Income Housing Tax Credits in Rural Areas, at *https://www.federalreserve.gov/econres/feds/files/2018077pap.pdf.*

[4] *See* Carpenter, Ann; White, Douglas; Hirt, Mary; Assessing the Use of Low Income Housing Tax Credits in Rural Areas and Rental Housing Affordability in the Southeast: Data from the Sixth District, at *https://www.frbatlanta.org/community-development/publications/discussion-papers/2018/02-rental-housing-affordability-in-the-southeast-2018-07-19.aspx.*

[5] *See* Gyourko, Joseph E., and Raven Molloy (2015). "Regulation and Housing Supply," in Duranton, Gilles, J. Vernon Henderson, and William C. Strange eds., Handbook of Regional and Urban Economics. Volume 5B. Handbook of Regional and Urban Economics. Amsterdam; San Diego and Oxford: Elsevier, pp. 1289–1337.

evolve, the Board will continue to monitor developments in agriculture and the potential for implications in other segments of the national or regional economy. Prior to the emergence of global economic developments related to COVID–19, growth in farm lending continued to show signs of slowing. We recognize that the sector-related weakness we had seen has been compounded by COVID–19, and that agricultural borrowers may experience hardships in meeting all of their contractual obligations. Our long-standing practice has been to encourage financial institutions to work constructively and proactively with borrowers, including agricultural borrowers, and to consider prudent loan modifications consistent with safe and sound lending practices to strengthen the credit and mitigate credit risk.

As a complement to our ongoing monitoring of agricultural conditions and lending, and routine supervisory activities, the Federal Reserve also hosts biannual National Agricultural Credit (NAC) conferences. The NAC conferences serve as an exchange of information in Washington, DC. and across all of the Federal Reserve Districts on developments in agricultural finance among institutions involved in various aspects of agricultural lending, regulation, and research. Among other conferences focused on the agriculture sector, the NAC meetings serve as an important source of information and have been of great value. The Washington meetings concentrate on policy-related matters that have an effect on agricultural finance conditions and lending. Discussions may focus on a wide range of policies, including farm, energy, trade, regulatory, monetary or other areas as conditions evolve. The Federal Reserve District meetings focus on agricultural and lending conditions within the region that a meeting takes place, and include academic researchers focusing on issues related to agricultural finance.

Q.3. I recently wrote to Comptroller Otting, with colleagues on this Committee, to express the importance of considering the many unique challenges in accessing financial services in rural America. It is imperative that the CRA work for communities throughout America, and that the process for potential reforms to this vital rule should reflect that. Any updates to the CRA should be done in coordination between your three agencies, and must be consistent with the original purpose of this Civil Rights-era law to bringing financial services and credit access to low- and moderate-income and underserved communities throughout our country.

As you consider changes to the Community Reinvestment Act, how are you considering and engaging rural America?

A.3. As we have explored Community Reinvestment Act (CRA) reform options, we have engaged with rural stakeholders in a number of ways. First, we partnered with the Federal Reserve Banks to hold 29 external roundtables in 2018 and early 2019 with attendees that included representatives of consumer and community organizations and banks. The Board published a summary of the key findings from these roundtables in June of 2019.[6] These roundtables also included organizations and financial institutions

[6] Board of Governors of the Federal Reserve System, "Perspectives from Main Street: Stakeholder Feedback on Modernizing the Community Reinvestment Act," (PDF) (Washington: Board of Governors, June 2019).

focused on rural concerns and reflected a number of recommendations related to rural communities.

We also continue to conduct research that helps inform our understanding of rural issues. For example, a Federal Reserve report issued in November 2019 focused on branch access in rural areas and helped inform our CRA regulatory approach on retail services.[7] This report found that just over 40 percent of rural counties lost bank branches between 2012 and 2017, with 39 rural communities being "deeply affected" by the loss of more than half of their bank branches.

The Federal Reserve also reviewed the more than 1,500 comments submitted in response to the Advance Notice of Proposed Rulemaking (ANPR) that the Office of the Comptroller of the Currency (OCC) published in 2018. A number of the comments submitted in response to the ANPR focused on ways to improve the CRA to better meet the needs of rural communities. In considering any CRA reforms, we will continue to focus on ensuring the needs of rural communities are well-served. We are reviewing the comments that have been submitted to the OCC and Federal Deposit Insurance Corporation on their Notice of Proposed Rulemaking (NPR), and we expect to learn much—including much related to the aspects of the NPR that reflect our own input—from the review.

Q.4. I would like an update on an issue I've followed and written to the Federal Reserve and FDIC about, the "covered funds" definition in the Volcker Rule. As drafted, banks are prevented from activities that they are regularly allowed to do directly on their balance sheets. Oftentimes clients, such as large pension funds, want their banks to provide long-term investments or loans in these fund structures to have some skin in the game. I continue to strongly support the Volcker Rule's purpose of preventing speculative trading that is at odds with the public interest. As your agencies continue their process here, I encourage you to work toward an outcome that allows capital for growing and innovating companies and the ability to invest in long-term investment vehicles, while keeping a focus on preventing the activities that the rule is intended to stop.

As your agencies look at the impact of rules and any potential changes, will you consider activities that are considered safe and allowable elsewhere in banks? And especially the impact on the availability of funding for companies in the middle of America looking to grow?

A.4. On January 30, 2020, the Board, the Federal Deposit Insurance Corporation, the OCC, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (the Agencies) jointly issued a notice of proposed rulemaking (NPR)[8] addressing the covered funds provisions of the Volcker Rule regulations. The NPR, which was developed jointly by the Agencies, includes provisions that would give banking entities increased

[7] Board of Governors of the Federal Reserve System, "Perspectives from Main Street: Bank Branch Access in Rural Communities," (PDF) (Washington: Board of Governors, November 2019).

[8] *See https://www.federalreserve.gov/aboutthefed/boardmeetings/files/volcker-rule-fr-notice-20200130.pdf.*

flexibility to invest in and sponsor venture capital funds and funds that extend credit.

Q.5. Thank you all for your updated guidance on providing financial services to the hemp industry. As you know, this is an issue that has been very important to me. Montana leads the country in hemp production, and this guidance will help our producers and the financial institutions that are now able to serve them.

Q.5.a. What will your agencies be doing to educate your examiners and the institutions that you oversee to adapt to working with hemp-related businesses?

A.5.a. The Federal Reserve will provide training to examiners on this topic through our regular Systemwide Bank Secrecy Act (BSA) trainings, as well as in conjunction with the other Federal banking regulators through classes and seminars provided by the Federal Financial Institutions Examination Council.

Q.5.b. Are there areas that you anticipate will require additional guidance?

A.5.b. As stated in the December 3, 2019, statement,[9] the Financial Crimes Enforcement Network (FinCEN) will issue additional guidance on BSA requirements for hemp businesses after further reviewing and evaluating the U.S. Department of Agriculture interim final rule. Some banks, for example, have asked questions that involve interpretations of FinCEN's customer due diligence rule with respect to hemp (*e.g.,* a bank's obligation to determine whether a hemp producer in a customer's supply chain is operating lawfully).

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

Q.1. Earlier this year, Comptroller Otting said that the Office of the Comptroller of the Currency (OCC) was taking the lead on writing a rule to rein in risky incentive-based compensation practices at large financial institutions that reward senior bank executives for irresponsible risk-taking. Additionally, at a House Financial Services Committee hearing in May, Otting said that the OCC shared its proposal with the Securities and Exchange Commission (SEC).

Chair McWilliams and Vice Chair Quarles, has Comptroller Otting shared the OCC's proposal with either of your agencies?

- If yes, what does the proposal contain?
- If yes, are all six regulators on board with the proposal?
- If yes, when can we expect to see a notice of proposed rulemaking posted?

A.1. Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Housing Finance Agency, Securities and Exchange Commission, and National Credit Union Agency (the agen-

[9] *See https://www.fincen.gov/sites/default/files/2019-12/Hemp%20Guidance%20%28Final%2012-3-19%29%20FINAL.pdf.*

cies) to jointly establish regulations or guidelines that require disclosure related to incentive compensation arrangements, and that prohibit incentive compensation arrangements that could provide excessive compensation or lead to material financial loss. Federal Reserve staff has been working with staff from these other agencies to draft a regulation that would meet this statutory mandate.

Q.2. Have all six regulators (FDIC, Fed, NCUA, SEC, OCC, and FHFA) sat down together to discuss this rulemaking?

- If yes, when did these discussions take place?
- If yes, have all six regulators decided to move forward with a proposed rule?

A.2. Staff of all six regulators have been meeting regularly to determine a way to move forward. These discussions are continuing.

Q.3. If the OCC decides to move forward on executive compensation rule without all six regulators, are you concerned the OCC will create two different standards, encouraging banks to shop for the regulator with the weakest requirements?

A.3. There is a longstanding practice of Federal financial regulators working together on issues related to incentive-based compensation. For example, the Federal banking agencies jointly issued Guidance on Sound Incentive Compensation Policies in June 2010. The agencies also jointly issued proposed rules on incentive-based compensation in 2011 and 2016, and are working together on recent discussions concerning these issues. We fully anticipate that the agencies will continue to work jointly on this topic.

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

BB&T–SunTrust Merger

Competitive Effects

Q.1. The Fed evaluated how the transaction would affect competition in 81 geographic markets.[1] These geographic markets are the areas used to measure the concentration of the relevant banking products. Were the definitions of any predefined markets altered from the time the merger application was filed to the time of the merger approval?

[1] Federal Reserve System, "Order Approving the Merger of Bank Holding Companies," *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191119a1.pdf.*

A.1. In evaluating merger proposals, Federal Reserve staff considers whether pre-existing geographic market definitions are appropriate. It is common for Federal Reserve staff to consider redefining markets as part of its review of merger proposals. The Federal Reserve evaluates its existing geographic market definitions under the relevant legal standard set out in Supreme Court precedents, which require that the relevant geographic market reflect the area where "the effect on competition will be direct and immediate."[1] In reassessing its geographic markets, the Federal Reserve looks to demand and substitution—that is, possible consumer responses to changes in rates, fees, or other characteristics of banking services.[2] Local conditions, including commuting patterns and economic activity, are closely evaluated as part of this analysis. For this merger proposal, the Board examined available data for the relevant geographic markets and, as a result, redefined 16 markets to more accurately reflect current local competitive conditions, including with respect to commuting patterns and consumer economic activity. Some markets increased in concentration, while others decreased, as a result of the market re-definitions. Three markets were absorbed by other markets due to updated commuting data.

Q.2. Approval Order mentions that the "Board has considered the relative shares of total deposits in insured depository institutions that BB&T would control."[2] Did the Fed conduct a competitive analysis of any other product markets, such as small business lending or home mortgage lending? If not, why not?

[2] *Id.*

A.2. As required by Supreme Court precedent, the Board considered the cluster of products and services provided by commercial banks—that is, commercial banking—in evaluating the proposal by BB&T.[3] According to the Supreme Court in Philadelphia National Bank, "the cluster of products (various kinds of credit) and services (such as checking accounts and trust administration) denoted by the term 'commercial bank' . . . composes a distinct line of commerce."[4] Indeed, the Supreme Court in Phillipsburg National Bank & Trust Company explicitly rejected "submarkets" in the product market for evaluating the effect of competition of a merger between commercial banks because they were "not a basis for the disregard of a broader line of commerce that has economic significance."[5] In light of this precedent, the Board focused its competition review of the BB&T–SunTrust merger proposal on the commercial banking line of commerce.

While the Board is required to focus its competitive inquiry in bank merger applications on the cluster of products and services that constitute commercial banking, it may investigate the competitive effects in submarkets if the parties or outside commenters raise a specific submarket as a potential issue. In the BB&T–SunTrust merger proposal, the Board reviewed competitive effects in mortgage lending in response to concerns raised by a commenter.

Q.3. According to the Approval Order, in 13 of the geographic markets, the Herfindahl Hirschman Index (HHI) levels for deposits

[1] *See* Philadelphia National Bank and Phillipsburg National Bank & Trust Co., *supra note* . . . [*sic*].

[2] *See* Federal Reserve and Department of Justice Frequently Asked Questions, question 10, available at *https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm#faq10.*

[3] *See* Philadelphia National Bank, *supra n.* Error! Bookmark not defined . . . [*sic]; see also United States v. Connecticut National Bank,* 418 U.S. 656 (1974); Phillipsburg National Bank & Trust Co., *supra n.* Error! Bookmark not defined . . . [*sic*]

[4] Philadelphia National Bank, *supra n.* Error! Bookmark not defined . . . [*sic*] at 356.

[5] *Id.* at 360. In *Phillipsburg,* the Supreme Court overturned a lower court decision, which focused its attention on "different groupings within" the commercial banking line of commerce.

would exceed one or both of the 1800/200 thresholds, meaning that the expected change in market concentration is significant.[4]

[4] *Id.*

Q.3.a. For the six markets where credit unions or thrifts mitigated the competitive concerns, please identify which credit unions and thrifts were included in the analysis, the dollar amount of their deposits, and any weights used for these institutions.

- *North Lake-Sumter, Florida:* Four credit unions were included at 50 percent weight:
  - Suncoast Credit Union: $120 million
  - Insight Credit Union: $103 million
  - Campus USA Credit Union: $79 million
  - Central Florida Educators Federal Credit Union: $75 million
- *Atlanta, Georgia:* Two thrifts were included at 100 percent weight and six credit unions were included at 50 percent weight:
  - Newton Federal Bank (thrift): $219 million
  - Cornerstone Bank (thrift): $209 million
  - Delta Community Credit Union: $4.5 billion
  - Georgia's Own Credit Union: $1.8 billion
  - Associated Credit Union: $1.2 billion
  - IBMSECU: $431 million
  - First Tech Federal Credit Union: $196 million
  - Wings Financial Credit Union: $156 million
- *Milledgeville Area, Georgia:* Two credit unions were included at 50 percent weight:
  - Robins Financial Credit Union: $97 million
  - Midsouth Community Credit Union: $50 million
- *Lexington, Virginia:* Two credit unions were included at 50 percent weight:
  - DuPont Community Credit Union: $24 million
  - Beacon Credit Union, Inc.: $18 million
- *Norfolk-Portsmouth, Virginia-North Carolina:* One thrift was included at 100 percent and eight credit unions were included at 50 percent:
  - Dollar Bank (thrift): $131 million
  - Chartway Federal Credit Union: $1.1 billion
  - Langley Federal Credit Union: $567 million
  - ABNB Federal Credit Union: $482 million
  - BayPort Credit Union: $437 million
  - NAE Federal Credit Union: $110 million
  - Northern Star Credit Union: $72 million
  - Bronco Federal Credit Union: $55 million
  - 1st Advantage Federal Credit Union: $43 million
- *Richmond, Virginia:* One credit union was included at 50 percent weight:
  - Virginia Credit Union, Inc.: $2.3 billion

Unlike banks and thrifts, credit unions are not required to report deposits on a branch-level. Please indicate how the Fed obtained the deposit levels for credit union branches. If estimates were used, please describe the methodology.

A.3.a. As a general matter, when the Federal Reserve includes credit unions as a mitigating factor in its competitive analysis, it takes the total deposits of the credit union and divides the deposits by the total number of branches of the credit union to estimate the deposits held at each branch. However, in some cases, the Department of Justice (DOJ) obtains specific information about deposits held at branches by particular credit unions. When exact deposit information is available, the Board relies on that more specific information in its competitive analysis.

Q.3.b. For the seven markets with divestitures, do any of these markets still approach either of the HHI thresholds even after considering the divestitures? If so, please indicate the geographic market and the HHI-levels before and after the merger.

A.3.b. The competitive effects of the proposal in these seven markets are described in extensive detail in the Board's public order. Each of these markets satisfied the DOJ Bank Merger Guidelines taking into consideration the divestitures—in each market the HHI increase would be less than 200 points or the pro forma HHI would be less than 1800 points. Specifically, pages 17 through 24 of the Board's order provide the pro forma HHI calculations and increase in HHI in each of the seven markets with divestitures. The pro forma HHI calculations are reproduced below for each of these markets:

- *Eastern Shore, Virginia (page 19 of the Board's order):* HHI increase of 3 points to 2043.
- *Martinsville, Virginia (page 19 of the Board's order):* HHI would decrease by 2 points to 2125.
- *South Boston, Virginia (page 20 of the Board's order):* HHI would increase 1 point to 1638. The Board required a divestiture in this market while the DOJ did not require a divestiture.
- *Lumpkin County, Georgia (page 21 of the Board's order):* HHI would decrease by 36 points to 2248.
- *Wayne County, Georgia (page 22 of the Board's order):* HHI would increase 4 points to 2057. The Board required a divestiture in this market while the DOJ did not require a divestiture.
- *Winston-Salem, North Carolina (page 23 of the Board's order):* HHI would increase by 30 points to 6429.
- *Durham-Chapel Hill, North Carolina (page 24 of the Board's order):* HHI would increase 29 points to 2162.

Financial, Managerial, and Other Supervisory Conditions

Q.4. Please describe the process by which the Fed evaluated the financial soundness of the resulting institution.

A.4. Staff thoroughly reviewed the information provided in the application, as well as supplemental information provided by the organizations. Staff also considered the Federal Reserve's supervisory reviews, follow-up work, and ongoing monitoring activities. In addition, staff consulted with relevant financial supervisory agencies and reviewed confidential supervisory information, including examination reports on the bank holding companies and the depository institutions involved. Staff also reviewed the financial condition of the organizations on both parent-only and consolidated bases, as well as information regarding the financial condition of the subsidiary depository institutions and the organizations' significant nonbanking operations. The review included, but was not limited to, the capital adequacy, asset quality, liquidity, and earnings performance of both BB&T and SunTrust. Additionally, staff considered the future prospects of the combined organization, its pro forma financial condition, the proposed business plan, and its ability to absorb the costs of the proposal and effectively integrate the institutions' operations. Staff also considered an updated capital plan provided by BB&T and the ability of the combined company to maintain adequate capital levels in baseline and stressed conditions.

Q.5. Please describe the process by which the Fed evaluated the management of the resulting institution.

A.5. Staff considered information provided by BB&T relative to its proposed personnel appointments, managerial structure, and oversight plans, to assess managerial resources and plans for operating the combined organization. Similar to our financial analysis, staff reviewed the confidential supervisory records of BB&T, SunTrust, and their subsidiary depository institutions, including assessments of their management, risk-management systems, operations, and compliance with banking laws and regulations. Staff also considered the policies, procedures, and controls in place at the organizations, as well as the risk-management program under development for the combined organization, the proposed integration plans, and the combined organization's ability to meet the enhanced regulatory requirements applicable to bank holding companies with $250 billion or more in total consolidated assets.

Q.6. On the same day the merger was approved, the Federal Reserve issued a consent order against SunTrust as a result of misleading or inaccurate statements to business customers about the operation and billing of certain add-on products.

Q.6.a. Are any executives who were in the chain of command responsible for these violations in a leadership position of the new Truist Bank?

A.6.a. As noted on pages 52–53 of the Board's order, a newly hired Chief Compliance Officer (CCO) at Truist Bank reports directly to Truist's Chief Risk Officer (CRO), formerly the BB&T CRO, who leads the Truist Bank risk management function. The CRO and CCO's direct report, the leader of the Fair Lending and Responsible Banking team, also a legacy BB&T employee, is primarily responsible for unfair and deceptive practices (UDAP) compliance, as well as implementation of an enhanced, firm-wide compliance risk management program. For these reasons, and other reasons explained in the Board's approval order, the Board found that the UDAP compliance program of the combined company would be consistent with approval of the proposal.

Q.6.b. In the last 5 years, SunTrust was the subject of multiple enforcement actions, including by the Fed, the Securities and Exchange Commission, the CFPB, the DOJ and multiple State attorneys general.[5] Are any executives who were in the chain of command responsible for these violations in leadership positions of the new Truist Bank?

[5] Good Jobs First, *https://violationtracker.goodjobsfirst.org.*

A.6.b. The enforcement actions brought by the Board and other financial regulators were taken against SunTrust or its subsidiaries, rather than any individuals. Individuals may be subject to enforcement actions by the Board, if the relevant legal standards are met. Please see response to question 3(a) above regarding leadership at Truist Bank.

Q.6.c. In the last 5 years, BB&T has been the subject of five enforcement actions by the Securities and Exchange Commission.[6] Are any executives who were in the chain of command responsible for these violations in leadership positions of the new Truist Bank?

[6] Good Jobs First, *https://violationtracker.goodjobsfirst.org.*

A.6.c. The enforcement actions brought by the Securities and Exchange Commission were taken against BB&T subsidiaries, rather than any individuals. Individuals may be subject to enforcement actions by the Board if the relevant legal standards are met.

Convenience and Needs Considerations

Q.7. The Fed is required by the Bank Holding Company Act to note and consider each institution's performance under the Community Reinvestment Act (CRA). As stated in the Approval Order, while BB&T has an outstanding record of meeting community credit needs, SunTrust only has a satisfactory record. "With respect to SunTrust Bank, [CRA] examiners noted that some branch closures and consolidations by SunTrust Bank may have adversely affected the accessibility of banking services in some of the bank's [Assessment Areas]."[7] This effect on accessibility included eight branch closures in low-income tracts and 21 closures in moderate-income tracts.

[7] *Id.*

Q.7.a. Does the Fed find it appropriate to reward an institution for failing to meet the credit needs of the communities it serves?

A.7.a. As indicated in the Board's order, SunTrust had a satisfactory CRA record, including high satisfactory ratings for the Lending and Investment tests. More importantly, BB&T, the successor institution, has an overall outstanding CRA rating.

Q.7.b. How will the Fed ensure that Truist does not engage in similar practices in the future?

A.7.b. As indicated in the Board's order, the Federal banking supervisory agencies evaluate a bank's record of opening and closing branches, particularly branches located in LMI geographies or primarily serving LMI individuals, as part of the CRA examination process.[6]

Q.7.c. During the merger review process, BB&T and SunTrust agreed to a "3-year, $60 billion community benefits plan," that will "increase financial resources for low- and moderate-income (LMI) communities across the eastern United States." How will the Fed ensure that Truist complies with this agreement?

A.7.c. Neither the CRA nor the Federal banking agencies' CRA regulations require depository institutions to make pledges or enter into commitments or agreements with any organization.[7] Lending, investments, or services that Truist Bank provides, including those in furtherance of its community benefits plan, will be taken into account as part of the FDIC's CRA evaluation of Truist Bank.

Q.7.d. Of all the merger applications that have been withdrawn, how many were withdrawn because of a bank's CRA performance record?

A.7.d. The Federal Reserve System has released publicly its approach to applications that may not satisfy requirements for approval or that otherwise raise supervisory or regulatory concerns.[8] Potential applicants with supervisory issues, including with respect to CRA or consumer compliance, may therefore choose not to file applications until the issues are resolved.[9] Applications can be withdrawn at the request of the applicant for any number of reasons. For example, an applicant may withdraw for technical or procedural reasons, for reasons regarding the statutory factors that must be considered by the Federal Reserve that could include supervisory issues, or because an applicant has decided not to pursue the application for business or strategic reasons. In many cases, applicants do not provide specific reasons for withdrawing filings and are not required to do so. As a result, the Board does not have sufficient information to provide the number of cases withdrawn due to CRA considerations.

Q.8. The Approval Order states that "several commenters alleged that BB&T and SunTrust were not meeting the credit needs of minority and LMI communities and borrowers, particularly in Florida and Durham, North Carolina, or unbanked and underbanked populations. One commenter alleged that BB&T made a disproportionately low number of home purchase loans to African American and Latino borrowers in the Houston, Texas, New York, New York, and Charleston, West Virginia, areas based on data reported for 2017 under HMDA."[8]

[8] *Id.*

Following this statement, the Approval Order explains how BB&T denies the commenters' allegations. It later states that "The

[6] *See, e.g.,* 12 CFR 228.24(d)(2). In addition, the Board noted that the FDIC, as the primary Federal supervisor of Truist Bank, would continue to evaluate the bank's branch closures in the course of conducting CRA performance evaluations.

[7] *See, e.g.,* CIT Group, Inc., FRB Order No. 2015–20 at 24 n.54 (July 19, 2015); Citigroup Inc., 88 Federal Reserve Bulletin 485 (2002); Fifth Third Bancorp, 80 Federal Reserve Bulletin 838, 841 (1994).

[8] This approach is reflected in SR 14–2 *supra n.* Error! Bookmark not defined . . . [*sic*]

[9] For example, financial holding companies with less-than-satisfactory CRA ratings are prohibited from acquiring companies engaged in financial activities in reliance on section 4(k) of the BHC Act. 12 U.S.C. § 1843(l)(2).

Board is concerned when HMDA data reflect disparities in the rates of loan applications, originations, and denials among members of different racial or ethnic groups in local areas. These types of disparities may indicate weaknesses in the adequacy of policies and programs at an institution for meeting its obligations to extend credit fairly. However, other information critical to an institution's credit decisions is not available from HMDA data."[9]

[9] *Id.*

Q.8.a. Did the Fed rely on BB&T's denials to determine that these allegations of lending discrimination not take place?

A.8.a. In evaluating bank applications, the Federal Reserve relies on the banks' overall compliance record, including recent fair lending examinations. In addition, the Federal Reserve considers the CRA records of the relevant depository institutions, assessments of other relevant supervisors, the supervisory views of examiners, and information provided by the applicant and public commenters. Regarding the BB&T–SunTrust application, the Board considered all comments, including the specific allegations raised by the commenters that you reference. To evaluate the comments, as well as to consider whether the relevant institutions are helping to meet the credit needs of their communities and the potential effects of the proposal on the convenience and needs of the communities to be served, the Board considers the information provided by the applicant, public comments, and the institutions' examination records, including fair lending.

Q.8.b. Does HMDA data indicate that these disparities do exist? If so, what information was used to reach the conclusion that these concerns did not warrant further scrutiny and denial of the merger?

A.8.b. As indicated in the Board's order, Home Mortgage Disclosure Act (HMDA) data disparities must be evaluated in the context of other information regarding the lending record of an institution. Publicly available HMDA data do not provide a sufficient basis for conclusively determining whether an institution has engaged in discriminatory practices.[10] Public 2017 HMDA data available for the evaluation of this application did not include consumer credit scores, debt-to-income ratios and loan-to-value ratios.

In evaluating bank applications, the Federal Reserve relies on the banks' overall compliance record, including recent fair lending examinations, assessments of other relevant supervisors, and the supervisory views of examiners.

Q.8.c. What additional information that is "critical to an institution's credit decision" would the Fed have needed to make a decision about whether BB&T was "meeting its obligations to extend credit fairly?"

A.8.c. As mentioned above, public 2017 HMDA data available for the evaluation of this application did not include consumer credit scores, debt-to-income ratios and loan-to-value ratios. When warranted by risk factors, examiners obtain additional information

[10] *Lee v. Board, supra n.* Error! Bookmark not defined . . . [*sic*] at 915 (holding that the Board carefully considered the concerns expressed by the commenters and properly resolved the HMDA data-related allegations).

when conducting fair lending examinations to evaluate an institution's compliance with fair lending laws and regulations.

Q.9. On the same day the merger was approved, the Federal Reserve issued a consent order against SunTrust as a result of misleading or inaccurate statements to business customers about the operation and billing of certain add-on products.[10]

[10] United States of America before the Board of Governors of the Federal Reserve System, "Consent Order," *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191119a2.pdf.*

Q.9.a. When did the Fed first become aware of the activities SunTrust was engaging in that led to the consent order being issued?

A.9.a. Federal Reserve staff became aware of the practices addressed in the Consent Order beginning in 2016.[11] Those practices were terminated by SunTrust Bank around the same time.

Q.9.b. When was it decided that it would be appropriate to publicly release the consent order at the same exact time as the announcement of the Fed approval of the merger? Who made that decision?

A.9.b. The Consent Order and merger application were voted on and approved by the Board at the same time. Staff's investigation of the matters underlying the Consent Order was completed prior to the Board's consideration of action on the application. Further, aligning the processing of these two matters was reasonable because the issues identified in the Consent Order needed to be addressed as part of the Board's consideration of the statutory factors for determining whether to approve the application.

Q.10. In assessing the convenience and needs factor, the Fed considered the supervisory views of the Consumer Financial Protection Bureau.[11]

[11] Federal Reserve System, "Order Approving the Merger of Bank Holding Companies," *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191119a1.pdf.*

Q.10.a. What were those views?

A.10.a. As indicated in the Board's order, the Board considered the views of the CFPB regarding the consumer compliance records of both Branch Banking and Trust Company (Branch Bank) and SunTrust Bank. These interagency discussions and views are considered confidential supervisory information. The CFPB Director voted to approve the merger in the Director's capacity as a member on the FDIC board of directors.

Q.10.b. Did the Fed review the Bureau's Consumer Complaint data base in evaluating the merger?

A.10.b. As mentioned above, the Board considered the views of the CFPB regarding the consumer compliance records of both Branch Bank and SunTrust Bank.

[11] *See* In the Matter of SunTrust Bank, Docket No. 19–028–B-SM (Nov. 19, 2019), available at *https://www.federalreserve.gov/newsevents/pressreleases/files/orders20191119a2.pdf.*

Q.10.c. A recent study has shown that SunTrust and BB&T ranked third and 12th in the most consumer complaints that year.[12] Does the Fed find those statistics concerning?

[12] American Banker, "BankThink: CFPB should have a say in bank mergers," Jeremy Kress, September 03, 2019, *https://www.americanbanker.com/opinion/cfpb-should-have-a-say-in-bank-mergers.*

A.10.c. Consumer complaints are taken seriously by the Federal banking agencies. Complaints that implicate fair lending and other consumer protection laws and regulations are taken into account as part of the assessment of an institution's consumer compliance record. The Board considered the views of the FDIC and the Federal Reserve Bank of Atlanta regarding the consumer compliance record of Branch Bank and SunTrust Bank, respectively. In addition, the Board considered the views of the CFPB regarding the consumer compliance records of both Branch Bank and SunTrust Bank.

Financial Stability Factor

Q.11. The Approval Order states that "In light of all the facts and circumstances, this transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the U.S. banking or financial system."

Q.11.a. Countrywide was a $200 billion institution when it failed.[13] Washington Mutual was $307 billion.[14] Together, they had the potential to do significant damage to the deposit insurance fund. Why does the Fed believe that the failure of a $450 billion institution would not present risks to the financial system?

[13] New York Times, "Bank of American to buy Countrywide," Gretchen Morgenson and Eric Dash, January 11, 2008, *https://www.nytimes.com/2008/01/11/business/worldbusiness/lliht-bofa.3.9157464.html.*

[14] M. Reuters, "WaMu is largest bank failure," Elinor Comlay and Jonathan Stempel, *https://www.reuters.com/article/us-washingtonmutual-jpmorgannews1/wamu-is-largest-u-s-bank-failure-idUSTRE48P05I20080926.*

A.11.a. As described in detail on pages 54–60 of the Board's public order, the Board conducted an extensive analysis of the risks to stability of the United States banking and financial system. In particular, the Board considered the combined organization's size, the extent to which BB&T and SunTrust engaged in activities that were critical to the functioning of the U.S. financial system and whether there would be adequate and timely substitute providers of such activities, data regarding potential financial instability being transmitted to other institutions or markets within the U.S. banking and financial system, the extent to which the combined organization would contribute to the overall complexity of the U.S. banking or financial system, and the cross-border activities of each of BB&T and SunTrust.

Based on each of these factors individually and in combination, the Board concluded that the transaction would not appear to result in meaningfully greater or more concentrated risks to the stability of the U.S. banking or financial system. In particular, the

Board noted that the combined organization would have a *de minimis* share of payment activities, assets under custody, and underwriting activities; have limited reliance on wholesale funding; have limited over-the-counter derivatives exposures and holdings of Level 3 assets; and engage in limited cross-border activities. In addition, the Board noted that both BB&T and SunTrust were predominately engaged in retail commercial banking activities with little reliance on short-term funding. The Board found that the combined organization would have minimal cross-border activities and would not exhibit an organizational structure, complex interrelationships, or unique characteristics that would complicate resolution of the firm in the event of financial distress. In addition, the Board found that the combined organization would not be a critical services provider or so interconnected with other firms or the markets that it would pose significant risk to the financial system in the event of financial distress.

Q.11.b. In a July 2018 speech advocating for deregulation of regional banks, you favorably cited Fed research showing that the failure of a single $250 billion bank would be far worse for the economy than the failure of five $50 billion banks failed separately. And yet you concluded last month that the $450 billion BB&T–SunTrust merger would not materially increase risks to financial stability. Was this research considered in the context of the BB&T–SunTrust merger?[15]

[15] "Remarks by Randal K. Quarles, Vice Chairman for Supervision, Board of Governors of the Federal Reserve System at American Bankers Association Summer Leadership Meeting," July 18, 2018.

A.11.b. The Board considers the resulting size of a financial institution when assessing the risks to financial stability, because larger financial firms generally pose a greater risk to the financial system and broader economy than smaller financial firms. However, asset size itself is not dispositive, and the Board considers additional factors to evaluate the potential threat to financial stability, including interconnectedness, complexity, cross-border activity, and substitutability for critical services.[12] Each of these factors was discussed in detail on pages 54–60 of the Board's order.

The July 2018 speech discussed tailoring regulation applicable to banks in the United States to reflect the variety of business models and risk profiles of those institutions. In particular, the Board's framework for supervision and regulation is designed to increase in stringency in tandem with the firm's size and systemic footprint. To offset risk, the Board requires larger firms to be subject to additional supervisory and regulatory requirements. In its consideration of the BB&T application, the Board considered these additional regulatory standards and requirements that would apply to the combined organization given the size of its total assets. As noted in the Board's order, BB&T represented that it had allocated additional staff resources to satisfy the additional regulatory requirements that would apply to bank holding companies with $250 billion or more in total consolidated assets. In addition, the combined organization would be subject to annual supervisory stress

[12] *See supra n.* Error! Bookmark not defined . . . [*sic*]

tests, company-run stress tests every other year, the countercyclical capital buffer, a supplementary leverage ratio, a liquidity coverage ratio requirement, and other reporting and liquidity requirements. These requirements would be more stringent than the requirements that would have applied to each of BB&T and SunTrust on a standalone basis.

Q.11.c. Please describe the extent to which the Fed considered the cost of failure of the merged institution in its review.

A.11.c. As noted in the Board's order, the Board considered the degree of difficulty in resolving the resulting firm. The Board noted that BB&T and SunTrust do not engage in complex activities, such as being a core clearing and settlement organization for critical financial markets, that might complicate the resolution process by increasing the complexity, costs, or timeframes involved in a resolution. Because the structure and scope of activities at the combined organization were not complex, the resulting firm would not engage in significant cross-border activities, and the combined organization would be predominately engaged in retail commercial banking activities, the resolution of the firm would be less complicated than that of the largest U.S. financial institutions.[13]

Q.12. The Approval Order also listed various metrics considered when evaluating the financial stability factor, including size and the availability of substitute providers. For each metric, please indicate if the Fed has established numeric thresholds to evaluate whether or not it is triggered. If so, please identify the thresholds. If not, please describe how those factors were evaluated?

A.12. As required by statute, the Federal Reserve considers the impact on financial stability of every bank holding company merger proposal.[14] The metrics discussed in the Board's order are evaluated in every proposal. Specifically, these metrics include measures of the size of the resulting firm, the availability of substitute providers for any critical products and services offered by the resulting firm, the interconnectedness of the resulting firm with the banking or financial system, the extent to which the resulting firm contributes to the complexity of the financial system, and the extent of the cross-border activities of the resulting firm.[15] Because these categories are not exhaustive, the Board may consider additional categories to inform its decision. In addition to using quantitative measures, the Board also considers qualitative factors, such as the opaqueness and complexity of an institution's internal organization, that are indicative of the relative degree of difficulty of resolving the resulting firm.

In this case, the Board also considered the Globally Systemic Important Bank ("G–SIB") Surcharge score of the combined organization. The G–SIB Surcharge score is a measure of a firm's systemic importance.[16] On consummation of the proposal, the combined organization would have a G–SIB method 1 score of approximately 30 basis points, well below the minimum threshold (130 basis points) that identifies a financial institution as a G–SIB.

[13] *See* BB&T Corporation, FRB Order No. 2019–16, at 59–60 (Nov. 19, 2019).
[14] 12 U.S.C. § 1842(c)(7).
[15] *See* Capital One Financial Corp., *supra n.* Error! Bookmark not defined . . . [*sic*]
[16] *See* 80 Fed. Reg. 49082 (Aug. 14, 2015).

Transparency

This bank merger is the largest to occur since the financial crisis and consumers deserve to have a complete understanding of the decisionmaking process that led to its approval.

Q.13. The depository data used for the anticompetitive analysis is nonconfidential information. As such, when will the Fed be publishing the full anticompetitive analysis it undertook when reviewing the merger?

A.13. The full anticompetitive analysis for review of the merger is published on pages 7–24 and 63–80 of the Board's order.

Q.14. American Banker published an interview with the top executives of BB&T and SunTrust in which Truist's chairman and CEO, Kelly King stated, "I was told by several senior regulators there was no legal reason to object to the deal."[16]

[16] American Banker, "Truist rising: With mega-merger clone, pressure to deliver," Paul Davis, December 9, 2019, *https://www.americanbanker.com/news/truist-rising-with-mega-merger-done-pressure-on-to-deliver*.

- Were you one of those senior level regulators?
- Did any Fed staff have conversations with the executives, or their representatives of either institution before the merger application was filed?
  - If so, please disclose the date, participants, and substance of the conversation.
  - Did the Fed provide any comment regarding the likelihood of the approval of the deal, including whether the Fed anticipated there being any legal barriers to approval?

A.14. The quote from Mr. Kelly King was published in an article on December 9, 2019, and appears to have been made after the Board's approval on November 19, 2019.[17] The Board concluded that all statutory factors that it was required to consider were consistent with approval based on its analysis of the application record.

As explained in Section III of my letter to you dated May 8, 2020, prospective applicants sometimes request to meet with Board staff before filing an application or prefiling and the Board considers it appropriate for staff to grant these requests. At the request of BB&T and SunTrust, members of Board staff met with representatives of the companies on February 22, 2019. Representatives from BB&T and SunTrust included members of senior management as well as external counsel for each company. Representatives from the Board included staff from the Division of Consumer and Community Affairs, the Division of Supervision and Regulation, the Division of Research and Statistics, and the Legal Division. BB&T and SunTrust representatives presented high-level information on a number of topics, including pro forma financial projections, information on geographic overlap, considerations related to the convenience and needs of affected communities, and early stage risk management and technology integration plans. Board staff listened to

[17] *See supra n.* Error! Bookmark not defined . . . [sic]

the presentation and shared absolutely no information regarding the likelihood of approval or legal barriers to approval.

In addition, members of Board staff attended a meeting at the DOJ on February 19, 2019, wherein representatives of BB&T and SunTrust presented their competitive analysis and initial proposed divestitures. Meeting participants included representatives from senior management at BB&T and SunTrust, BB&T's external counsel, SunTrust's external counsel, staff at the DOJ, and Board staff from the Legal Division and the Division of Research and Statistics. Once again, Board staff listened to the presentation made by BB&T and SunTrust representatives and shared absolutely no information regarding the likelihood of approval or legal barriers to approval.

Community Investment Act Reform

In response to questioning during the December 5, 2019, hearing, you stated that the proposal to modify the Community Reinvestment Act (CRA) released this week by the FDIC and OCC "has benefited from a lot of Fed input."

Q.15. Please describe which aspects of the proposal were based on input from the Fed.

A.15. The Federal Reserve has shared detailed analysis, data, and proposals related to possible metrics-based approaches with our counterparts at the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) in an effort to forge a common approach. The FDIC and OCC have considered this information and included in their proposal multiple metrics at the assessment level. For example, the OCC/FDIC metrics would evaluate a bank's distribution of the number of its retail loans to low-income tracts and low-income households.

Q.16. Please describe why the Federal Reserve declined to join the FDIC and the OCC in their proposed rulemaking. Specifically:

Q.16.a. Did career Fed staff disagree with or were otherwise unable to independently verify the analysis on the expected effects of the proposal?

A.16.a. We have had considerable engagement with the FDIC and OCC throughout the CRA reform process and have conducted research and analysis of various proposals. We are committed to getting CRA reform right and that is why we have focused so much on understanding the underlying data and potential impact of any proposal. We continue to believe the best outcome would be a joint interagency final rule which strengthens the CRA regulations to help banks better meet the credit needs of the local low- and moderate-income communities they serve and more closely align with changes in the ways financial products and services are delivered.

Q.16.b. Does the Fed believe the proposed rule could negatively impact credit availability and affordability among low-income and minority populations?

- If so, which aspects of the proposal trigger those negative effects? Please include any qualitative or quantitative analysis done by the Fed.

A.16.b. We are focused on developing a set of CRA reform ideas that are consistent with a few key principles. Specifically, we believe that revisions to the CRA regulations should reflect the credit needs of local communities and work consistently through the business cycle. They should be tailored to banks of different sizes and business strategies. They should provide greater clarity in advance about how activities will be evaluated. They should encourage banks to seek opportunities in distressed and underserved areas. And, they should recognize that the CRA is one of several related laws to promote an inclusive financial sector.

Q.16.c. When in the rulemaking process did the Fed determine that it would not join the proposal? Were there any issues not addressed by the questions above that contributed to the proposal?

A.16.c. While the Board did not join the FDIC and the OCC in their Notice of Proposed Rulemaking (NPR) revising elements of CRA regulation, the Board shared detailed analysis and proposals on CRA reform with our counterparts at the OCC and FDIC in the preparation of the NPR, and the NPR reflects much input from the Board. We are reviewing the comments that have been submitted to the FDIC and OCC on the NPR, and we expect to learn much—including much related to the aspects of the NPR that reflect our own input—from the review. As a result, it would be premature to identify any specific areas of disagreement—rather, we are all in the process of working to determine the best path forward. We continue to view a common approach as the best outcome, but we have not yet determined the best next steps to achieve that outcome.

Q.17. Will the Fed be releasing a separate reform proposal? Is it a possibility that the Fed will join the agencies in issuing a final rule? If so, what assurances would the Fed need to feel comfortable joining?

A.17. Please see the response to question 16.c.

Q.18. What are the consequences of different banks having a different set of CRA requirements to follow based on their regulator?

How would CRA changes impact the Fed's review of CRA-performance for bank mergers? If CRA-ratings are based on different sets of standards for each regulator, how will the Fed be able to objectively compare CRA-performance among the banks?

A.18. We continue to view a common approach to CRA reform as the best outcome. The proposed regulatory changes would not change how the Federal Reserve reviews CRA performance for bank mergers. The CRA statute requires the Board to take into account the CRA performance record of an institution in mergers and acquisitions applications and the Board will continue to abide by this requirement, consistent with the law.

Climate Change Risk

Q.19. On January 25, I signed a letter to Chairman Jay Powell regarding information on the Federal Reserve's steps to identify and manage climate-related risks in the U.S. financial system.[17] Chairman Powell's response on April 18 was disappointing, deferring responsibility to climate-related actions to other agencies.[18]

[17] Letter from 20 Senators to Chairman of the Board of Governors of the Federal Reserve System Jerome Powell, January 25, 2019, *https://www.schatz.senate.gov/imo/media/doc/Letter%20to%20Federal%20Reserve,%20OCC,%20FDIC%20re%20Climate%20Change.pdf.*

[18] Letter from Chairman of the Board of Governors of the Federal Reserve System Jerome Powell to Senator Warren, April 18, 2019. *https://www.schatz.senate.gov/imo/media/doc/Chair%20Powell%20to%20Sen.%20Schatz%204.18.19.pdf.*

Chairman Powell's April 18 response stated, "The Board's framework provides a systemic way to assess financial stability; however, some potential risks do not fit neatly into that framework."[19] However, central banks around the world, including the Bank of England are far more aggressive in is taking steps to incorporate climate-related risks in their financial stress tests.[20] The Network for Greening the Financial System, a group of 18 central banks and bank supervisors has also acknowledged that "climate-related risks are a source of financial risk [and it is] within the mandates of Central Banks and Supervisors to ensure the financial system is resilient to these risks."[21]

[19] *Id.*

[20] Reuters, "BOE to stress test its financial system against 'climate pathways': Carney," Kanishka Singh, October 8, 2019, *https://www.reuters.com/article/us-climate-change-boecarney/boe-to-stress-test-its-financial-system-against-climate-pathways-carney idUSKBN1WN0GS.*

[21] Network for Greening the Financial System, "NGFS First Progress Report," October 2018, *https://www.banque-france.fr/sites/default/files/media/2018/10/11/818366-ngfs-firstprogress-report-20181011.pdf.*

Please explain why the Federal Reserve System's framework does not currently incorporate climate-related risks in assessing financial stability, despite other international efforts to do so.

A.19. It is not correct to say that the Federal Reserve's framework for assessing financial stability does not incorporate climate-related risks or that we are disconnected from international efforts in this area.

First, staff across the Federal Reserve System conduct extensive research on a range of issues related to the effects of climate change, including how climate-related risks can be amplified by the financial system. Through their research, staff are exploring new sources of climate-related data and developing methods to link this climate data with existing financial data. This research helps inform our supervision and outreach to market participants by enhancing our understanding of connections between climate risks and financial stability. These efforts involve nearly every division of the Board of Governors, as well as several Reserve Banks. These efforts improve our ability to assess the ways climate-related risks may affect the economy, financial stability, and the safety and soundness of financial institutions.

Second, Federal Reserve personnel contribute integrally to efforts by the Financial Stability Board (FSB), which I chair, and other standard-setting bodies to assess climate-related financial risks. The FSB's Standing Committee on the Assessment of Vulnerabilities evaluates as part of its mandate the potential for technological and policy shocks related to climate change. I have directed the FSB to continue its sponsorship of the Task Force for Climate-related Disclosures, which engages with companies to promote consistent public disclosures related to the risks of climate change. And the G20 has made the FSB responsible for coordinating the work of these international bodies related to the effect of climate change on the financial sector, recognizing that a patchwork of sector-specific groups could miss the emergence of critical financial vulnerabilities. Federal Reserve staff and I remain in frequent contact with our supervisory colleagues in other jurisdictions, following closely their own climate-related projects.

Third, in addition to this work on the long-term analysis of climate-change risk, the Federal Reserve's near-term supervisory framework captures a series of potential near-term risks related to severe weather events. One example includes the possibility of large losses to property and casualty insurers from historically atypical timing, intensity, or frequency of severe weather damages. The loss-absorbing capacity of insurers and their connections to the broader financial system is an important part of our financial stability framework. In addition, we look at the potential operational disruptions at large financial institutions, including network outages or other weather-related disturbances, which could present a near-term risk to financial stability.

With regard to the Network for Greening the Financial System (NGFS), as I have stated publicly for over a year, including twice at previous hearings of the Senate Banking Committee, I have urged the NGFS to accept comprehensive participation from the Federal Reserve. Federal Reserve staff have attended many NGFS discussions and will continue to do so. We are exploring how the NGFS might allow us to participate further in a way that is consistent with the full range of our responsibilities.

Q.20. On November 8, the Federal Reserve Bank of San Francisco held a conference on "The Economics of Climate Change," which focused on "[discussing] quantifying the climate risk faced by households, firms, and the financial system; measuring the economic costs and consequences of climate change; accounting for the effects of climate change on financial asset prices; and understanding the potential implications of climate change for monetary, supervisory, and trade policy."[22]

[22] Federal Reserve Bank of San Francisco, "The Economics of Climate Change," November 8, 2019, *https://www.frbsf.org/economicresearch/events/2019/november/economics-of-climate-change/*.

Q.20.a. In her speech at the conference, President and Chief Executive Officer of the Federal Reserve Bank of San Francisco Mary Daly stated, "The Federal Reserve's job is to promote a healthy, stable economy. This requires us to consider current and future risks—whether we have a direct influence on them or not. Climate change is one of those risks."[23]

[23] Federal Reserve Bank of San Francisco, "Why Climate Change Matters to Us," Mary Daly, November 8, 2019, *https://www.frbsf.org/our-district/press/presidents-speeches/maryc-daly/2019/november/why-climate-change-matters-to-us/*.

- Does the Board of Governors of the Federal Reserve System disagree with President Daly's remarks that state that Federal Reserve is required to consider climate-related risks?
  - If so, please explain the position that the Federal Reserve is not required to consider climate-related risks.
  - If not, why has the Federal Reserve System not considered climate-related risks in its oversight of the financial system thus far?

A.20.a. Please see the response to question 19.

Q.20.b. During the conference, Federal Reserve Governor Lael Brainard stated that "Climate risks are projected to have profound effects on the U.S. economy and financial system," and that the "Federal Reserve has important responsibilities for safeguarding the stability of our financial system so that it can continue to meet household and business needs for financial services when hit by negative shocks. Similar to other significant risks, such as cyberattacks, we want our financial system to be resilient to the effects of climate change."[24]

[24] Board of Governors of the Federal Reserve System, "Why Climate Change Matters for Monetary Policy and Financial Stability," Lael Brainard, November 8, 2019, *https://www.federalreserve.gov/newsevents/speech/brainard20191108a.htm*.

- Has the Federal Reserve System formally assessed the systemic risks that climate change could pose to the financial system? If so, what tools and models does the Federal Reserve System use to inform those assessments?
- Has the Federal Reserve System assessed if the financial system is resilient to climate-related risks or taken any actions to increase the financial system's resilience to climate change?

A.20.b. As I stated previously, the Federal Reserve's framework for monitoring financial stability assesses several potential vulnerabilities to the financial system. These vulnerabilities, in turn, could be susceptible to a series of near-term climate-related risks. Assessments of the resilience of the U.S. financial system conducted by Federal Reserve staff are published biannually in our Financial Stability Report.

For the Federal Reserve's near-term macroeconomic analysis, we do take into account information on the severity of weather events. When a severe weather event occurs, we closely monitor the effects on local economies, assess the implications for broader measures of economic production and employment, and adjust our economic forecasts accordingly.

For example, our staff has relied on data from the Federal Emergency Management Agency and the Department of Energy to gauge the disruptions to oil and gas extraction, petroleum refining, and petrochemical and plastic resin production in the wake of hurricanes that have affected the Gulf region. Our staff regularly uses daily measures of temperatures and snowfall from the National Oceanic and Atmospheric Association weather stations to better understand how severe weather may be affecting measured and real economic activity in specific areas.

Our understanding of which economic activities will be affected by a severe weather event depends critically on data produced by the Federal statistical agencies, such as the Census Bureau's County Business Patterns data, as those data provide information on economic activity in different geographic locations. In addition, our staff uses credit and debit card transactions data for gauging how specific types of severe weather might be affecting consumer spending in areas affected by those events.

At present, neither we, or any other major central bank, directly models how changes in temperatures over long periods of time affect economic activity (modeling being a separate matter from the extensive economic analysis of this question that we do). But given that—the evolution of climate over time affects the economic data on which our models are built—including the trends and the cyclical behavior of investment, consumption, production, and employment—then climate change is incorporated in our macroeconomic analysis.

Other Topics

Q.21. A report released by the Financial Stability Board, of which you are currently chair, highlighted the risks of technology companies entering the banking sphere to the broader financial system.

Q.21.a. Can you please describe how both the FSB on an international level and the Federal Reserve on a domestic level are monitoring and evaluating these risks?

A.21.a. The FSB has published multiple reports on financial stability topics related to technology companies' roles in the financial sector. These include notes on cloud service provision, "BigTech" financial service provision, and use of decentralized financial technologies.[18] The FSB's 2020 work plan includes further work on BigTech service provision in emerging markets, a stock-take of financial regulators' and supervisors' use of technology, an update to the FSB's crypto-asset monitoring framework to incorporate stablecoins, and continuance of work underway on the Regulatory Issues of Stablecoins (RIS).[19] The RIS work was mandated by the G20 and will examine the regulatory issues of so-called "stablecoins" with the potential to reach a global scale—such as the Libra initiative—and will advise on multilateral responses as needed. This work picks up from the G7 Working Group on Stablecoins 2019 report.[20] The RIS working group issued a consultative document in April and is scheduled to submit a final report to the G20 during the third quarter of 2020.

[18] *https://www.fsb.org/2019/12/third-party-dependencies-in-cloud-services-considerations-on-financial-stability-implications/; https://www.fsb.org/2019/12/bigtech-in-finance-market-developments-and-potential-financial-stability-implications/; https://www.fsb.org/2019/02/fintech-and-market-structure-in-financial-services-market-developments-and-potential-financial-stability-implications/; https://www.fsb.org/2019/06/decentralised-financial-technologies-report-on-financial-stability-regulatory-and-governance-implications/.*

[19] *https://www.fsb.org/wp-content/uploads/P171219.pdf.*

[20] *https://www.bis.org/cpmi/publ/d187.pdf.*

In addition to contributing to FSB work, Federal Reserve staff are also active participants in work on related topics being conducted by the Basel Committee on Banking Supervision and the Committee on Payments and Market Infrastructures.

Domestically, Federal Reserve staff from multiple functions are following the interaction between banks and technology companies, including partnerships and third-party relationships, to assess potential consumer protection risks; risks to banks' safety and soundness; and financial stability risks.

In 2016, the Federal Reserve created two working groups with the task of with monitoring and analyzing financial technology ("fintech") and related emerging technology trends and undertaking related market intelligence. These working groups also conduct research related to our supervisory and payment system responsibilities. Several of the Board's divisions now have staff dedicated to policy and research around fintech and digital innovations in their respective areas of focus.

The Federal Reserve also coordinates regularly with the other Federal banking agencies on innovation-related matters in the supervision area. Our Consumer and Community Affairs division has convened an interagency fintech discussion forum to facilitate information sharing between Federal banking regulators on fintech consumer protection and financial inclusion issues. The Federal Reserve also engages in interagency discussion of fintech-related issues through the FFIEC's Task Force on Supervision and its Task Force on Consumer Compliance. One current area of focus is the Federal banking agencies' existing guidance on controls around partnerships and third-party relationships aimed at ensuring those activities are conducted in a manner consistent with safe and sound banking practices. The Federal Reserve staff are reviewing this guidance to determine whether any adjustments or clarifications would be helpful to promote responsible innovation.

Additionally, as noted by Chair Powell previously in congressional testimony, the Board has set up a multidisciplinary working group to analyze risk and policy implications of the Libra initiative which would help organize Federal Reserve input into the work of the FSB in this area. Areas of focus include monetary policy, payment system risks, consumer protection, Bank Secrecy Act/Anti-money Laundering compliance, and financial stability. The working group also has been meeting with other regulators, both domestic and international.

Last, Federal Reserve staff routinely meet with technology companies and banks, engaging with these companies to better understand how their products work and the associated risks. The Federal Reserve held its first in a series of office hour sessions with banks and financial technology companies to provide two-way learning opportunities for the companies and Federal Reserve staff.[21] Given the impact of the current economic stress, future office hour sessions have been postponed temporarily.

Q.21.b. Does the Federal Reserve have the sufficient tools to monitor and address these risks under the current regulatory framework?

[21] *https://www.federalreserve.gov/newsevents/pressreleases/other20191217a.htm.*

A.21.b. The FSB report highlighted a diverse set of potential benefits and risks from the provision of financial services by large technology firms. The Board has tools to monitor and address certain of the identified potential risks, while others fall outside of the authorities of the Federal Reserve.

As a general matter, the Federal Reserve does not directly regulate or supervise technology companies. Our regulatory and supervisory authority generally focuses on State member banks and bank holding companies.

However, the Federal Reserve does have some authority over technology companies that provide certain financial services to, or in partnership with, banks we supervise. Of most relevance is the Bank Service Company Act, which grants the Board (and the other Federal banking agencies) the authority to regulate and examine third-party service providers that perform certain services for depository institutions we supervise. Also, under the Federal Deposit Insurance Act, the Board has the enforcement authority to address unsafe and unsound practices, violations, and breaches of fiduciary duty by depository institutions we supervise and their institution-affiliated parties.

From a broader financial stability perspective, the Federal Reserve monitors risks to the financial system and works, usually with agencies at home and abroad, to help ensure the system supports a healthy economy for U.S. households, communities, and businesses. This monitoring includes vulnerabilities assessments, extensive research, and collaboration with other domestic agencies directly and through the Financial Stability Oversight Council (FSOC) to monitor risks to financial stability and to undertake supervisory and regulatory efforts to mitigate the risks and consequences of financial instability.

Q.22. On the Frequently Asked Questions page regarding the proposed FedNow services, it states that additional analysis is required to fully evaluate the relevant operational, risk, and policy considerations for both the Federal Reserve Banks and service participants.

When does the Fed expect to complete this analysis?

A.22. This language refers to the expansion of the Fedwire Funds Service and National Settlement Service (NSS) hours. The Federal Reserve Board (Board) is currently analyzing an expansion of operating hours for the National Settlement Service (NSS) and the Fedwire Funds Service, up to 24x7x365, to support a wide range of payment activities, including liquidity management for faster retail payments. As part of its analysis, the Board is engaging with industry participants in order to understand the industry's specific needs and readiness related to expanded hours.

In addition, the Board intends to publish at least two *Federal Register* notices in order to seek public comment on issues related to, and potential approaches for, expanding the Fedwire Funds Service and NSS operating hours, and announce its progress and any decisions related to expanded hours. The timeline for the Board's analysis will depend in part on the diversity and complexity of issues that the Board identifies during its review. Given the systemic importance of the Fedwire Funds Service, any decisions on expanding hours could have significant effects on market participants. The Board is committed to carefully evaluating the potential benefits, risks, and costs of any decision to expand hours of the Fedwire Funds Service and NSS.

As the Board considers expanding operating hours for NSS and the Fedwire Funds Service broadly, the Board will continue to assess the appropriateness of incremental changes to relevant operating hours in response to specific industry needs. For example, the Board recently completed analysis of an expansion of operating hours for NSS and the Fedwire Funds Service in order to allow for a third same-day automated clearinghouse (ACH) processing and settlement window. In December 2019, the Board announced an expansion of operating hours for NSS and the Fedwire Funds Service that will be implemented in March 2021 in order to add a third sameday ACH processing and settlement window.[22]

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

Q.1.a. This spring, the Office of Management and Budget issued a memorandum that for the first time required independent regulatory agencies such as yours to submit final rules to the Administration before publishing them.

Has the Federal Reserve submitted its final rules and guidance to OMB? If so, which ones?

A.1.a. Pursuant to the Congressional Review Act (Act), the Federal Reserve Board (Board) requests a determination from the Office of Information and Regulatory Affairs (OIRA), which is within the Office of Management and Budget (OMB), as to whether a rule is a major rule for purposes of the Act (*i.e.,* does the rule have an $100 million annual effect, or other substantial effect, on the economy). We submit these requests to OIRA for all final regulations that the Board issues, with the exception of regulations that fall within one of the exemptions under the Act.

The Board is currently reviewing OMB's 2019 memorandum on compliance with the Act with regard to the suggested procedures for submitting rules to OIRA in connection with its major rule determinations. We are considering how the 2019 memorandum applies to the Board's procedures for submitting rules under the Act. More broadly, in consultation with the other Federal banking agencies, we continue to assess the scope of supervisory guidance documents to send to OIRA and Congress under the Act.

Q.1.b. Did OMB ask you to make changes to any rulemaking?

A.1.b. With regard to requests submitted to OIRA pursuant to the Act, OIRA has not asked the Board to make any changes to any rulemakings.

Q.2. Without the Community Reinvestment Act, the homeownership rate in our country, and especially for Latinos and African Americans, would be much lower. UnidosUS published a report, Latino Homeownership 2007–2017: A Decade of Decline for Latinos, which found that that the CRA helped facilitate between

[22] *See https://www.federalreserve.gov/newsevents/pressreleases/other20191223a.htm.*

15 percent to as much as 35 percent of home loans to Latinos. How would proposed changes to CRA close the racial and ethnic homeownership gap?

A.2. As you noted, the Community Reinvestment Act (CRA) is an important law that ensures banks help meet the credit needs in all of the communities they serve. Throughout the reform process, the Federal Reserve has emphasized a set of core principles to guide our work and I believe that carrying out CRA reform consistent with these principles could help address homeownership credit needs for underserved families, including for communities of color. For example, any revisions to the CRA regulations should reflect the credit needs of local communities and work consistently through the business cycle. They should be tailored to banks of different sizes and business strategies. They should provide greater clarity in advance about how activities will be evaluated. They should encourage banks to seek opportunities in distressed and underserved areas. And they should recognize that the CRA is one of several related laws to promote an inclusive financial sector.

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

Q.1. One issue impacting banks in rural areas of my State are the limitations Regulation O places on the financial institution being able to serve the banking needs of their senior leadership. The regulation put in place in the late 1970s and its $100,000 limitation on extensions of credit to executives is most problematic. In most cases, a boat loan and an agriculture loan leave an officer in violation of this rule. An employee's children could not have all their car loans—or credit cards—with the bank that employs them. These banks have executive officers who have had to take out loans at other financial institutions because they've crossed the threshold, which is unfortunate. It is like forcing a Nike employee to wear Under Armor to work.

Because this issue affects so few individuals, it likely doesn't get much attention. Where does the Fed stand on modernizing this 40-year-old regulation by simply raising the threshold from the current $100,000 to $500,000, or an increased limit based on percentage of capital held by the bank—when inflation alone from the 1970s would place the limit well above these suggestions?

A.1. Regulation O (which implements sections 22(h) and (g) of the Federal Reserve Act) is intended to address the potential for conflicts of interest and self-dealing by bank executive officers. As you know, extensions of credit to executive officers of banks are limited because these individuals are in a position to have significant influence over the bank's credit decisions which can be improperly used to benefit the executive officer to the detriment of the bank. There is currently some important flexibility to the rule: banks are able to lend to executive officers to finance a child's education or to purchase or improve a home without limit, and the $100,000 lending limit only applies to loans for other purposes when the loans are not secured by liquid assets. Nonetheless, the problems you identify definitely merit our attention.

The Federal Reserve Board (Board) periodically reviews regulations to ensure that regulatory thresholds are set at an appropriate amount to support the objective of the rule. The Board expects to review Regulation O and as part of that review, it will consider whether the applicable threshold for extensions of credit to executive officers warrants adjustment. Obviously, any proposed change in the threshold would involve consultations with the other banking agencies.

Q.2. According to recent news accounts, the Federal Reserve does not plan to join the OCC and the FDIC in issuing a proposed rule to modernize CRA.

Q.2.a. Does the Fed believe that the CRA regulations should be updated? If so, how do you plan to proceed?

A.2.a. It is important to strengthen the Community Reinvestment Act (CRA) regulations to help banks better meet the credit needs of the local low- and moderate-income communities they serve, provide more clarity and consistency in our evaluations of banks, and more closely align with changes in the ways financial products and services are delivered.

The Board has shared detailed analysis and proposals with our counterparts at the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) in an effort to forge a common approach on CRA reform. We have spent a lot of time on research and analysis, and we are working to determine the best path forward. We continue to view a common approach as the best outcome, however, at this time, the Board has made no decisions regarding next steps.

Q.2.b. Do you believe that a consistent, interagency CRA regulation is preferable? Since the Fed does not plan to join the OCC/FDIC proposal, what is the likelihood that the Fed will be able to join its sister agencies in issuing an interagency final rule?

A.2.b. I continue to believe that a strong common set of interagency standards is the best outcome. As we work to develop a common regulatory approach, all of the agencies will benefit from the public comments on the current OCC and FDIC notice of public rulemaking.

Q.3. This Committee is considering legislation that would aim at providing some regulatory certainty to banks working with cannabis-related companies in the 47 States that have taken various steps toward legalization. Would legislation such as the SAFE Banking Act be a constructive step toward providing a framework for financial institutions to serve companies that comply with State cannabis laws?

A.3. In general, questions about legislative policy are the purview of Congress. It is our understanding that the Secure and Fair Enforcement Banking Act would provide that a bank that offers services to a marijuana-related business in a State that has legalized marijuana may not be held liable under Federal law solely for providing those services. Such legislation could provide financial institutions with some legislative clarity on the conflict between Federal and some State laws related to the legalization of marijuana. However, other aspects of Federal law and State law would likely remain in conflict, such as, for example, laws concerning certain types of use and distribution of marijuana.

RESPONSE TO WRITTEN QUESTION OF SENATOR JONES FROM RANDAL K. QUARLES

Q.1. The Federal Reserve conducts the Small Business Credit Access Survey every year. The Survey shows that many small business owners use personal credit cards to pay for business expenses. Small businesses have struggled to receive loans from traditional institutions and some have turned to online based loan servicers to fulfill their financing needs.

How have small businesses utilized financing from loan providers that are exclusively online? Are small businesses likely to return to traditional financial institutions after successfully receiving financing from internet based businesses?

A.1. As documented in the Federal Reserve Banks' Small Business Credit Survey, small business applications to online lenders have been increasing over the past few years.[1] The 2018 report[2] found that approximately 14 percent of all employer films, or 32 percent of those employer firms that had applied for financing over the previous 12 months, applied to at least one online lender. These data in the 2018 report demonstrate an increase from the data in the 2017 report, which found that approximately 10 percent of all employer firms, or 24 percent of those employer firms that had applied for credit in the previous year, applied to an online lender. This increase may reflect a growing awareness among small business owners of the existence of online lenders as a potential source of funding.

A more detailed analysis of the 2018 Small Business Survey data with respect to use of online lenders is provided in a report published by the Federal Reserve Bank of Cleveland.[3]

Nearly two-thirds of small businesses that applied to an online lender during the previous year also applied for credit from a traditional lender during the same period. Small businesses that applied to online lenders differ from those that applied only to traditional lenders along several dimensions. Businesses that applied to online lenders tended to be younger (but at least 3 years old), smaller with regard to both revenue and number of employees, less profitable, and riskier (as measured by self-reported credit scores) than small businesses that applied only to traditional lenders. Businesses seeking funding from online lenders were much more likely than those applying only to traditional lenders to report that they sought funds to cover operating expenses.

Applicants with medium- or high-credit risk were more likely to have their applications approved by online lenders than by small banks or large banks. Survey respondents reported that the most important factors leading them to apply for loans from online lend-

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[1] It is important to note that the Small Business Credit Survey is conducted using a convenience sample of small firms rather than a random sample.

[2] *See* 2018 Small Business Credit Survey: Rep ort on Employer Firms at *https://www.newyorkfed.org/smallbusiness/small-business-credit-survey-2018.*

[3] *See* Click, Submit 2.0: An Update on Online Lender Applicants from the Small Business Credit Survey at *https://www.clevelandfed.org/en/community-development/reports-by-topic/small-business.aspx.*

ers were the speed with which they would be provided a decision regarding their application or would receive funding, the probability of obtaining funding, and the absence of a collateral requirement.

We do not have data to respond to the question of whether small businesses that receive loans from online lenders are likely to subsequently apply for loans from traditional financial institutions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JELENA McWILLIAMS

Q.1. Please provide to the Committee a detailed list of all meetings with individuals or groups not directly affiliated with the agency you serve, from May 15, 2019, to present.

A.1. The FDIC Chairman's official calendar is available through the FDIC's website and is updated on a periodic basis. It can be viewed at *https://www.fdic.gov/about/freedom/chairmanschedule.html.*

Q.2. Recently, the FDIC approved the merger of BB&T and SunTrust—two institutions with a significant overlapping branch footprint. In November 2019, the Federal Reserve issued a report on bank branch access in rural communities.[1] The report found that most rural counties experienced a significant decline in bank branches between 2012 and 2017, but small businesses and certain consumers prefer using local banks and cannot find comparable financial products and services elsewhere.

The FDIC's Order and Basis for Corporation Approval of the merger states that the bank did not identify specific branches that would be closed or consolidated as a consequence of the merger, but have committed that Truist Bank would not have any merger-related branch closures for one year and would not have any merger-related branch closures in rural areas with populations under 2,500 for three years following consummation of the merger. How does the FDIC plan to enforce this commitment? Will the FDIC reject any application to close a branch submitted by Truist Bank under these parameters? In addition, please provide a list of the rural areas with populations under 2,500 described in the Order.

A.2. In evaluating any merger, section 18(c)(5) of the Bank Merger Act (BMA) directs the FDIC to consider the convenience and needs of the community to be served. In addition, the Community Reinvestment Act (CRA) requires the FDIC to take into account the CRA records of the institutions involved in the transaction.

The FDIC found that Truist Bank's (Truist) ability to meet the convenience and needs of the community to be served supported approval of the application. This finding was informed by, among other things, Truist's commitment to not pursue any merger-related branch closures for one year and to not pursue any merger-related branch closures in rural areas with populations under 2,500 for three years following consummation of the merger.

The FDIC has an inventory of Truist branches located in such rural communities (attached), which will enable the FDIC to mon-

[1] *https://www.federalreserve.gov/publications/files/bank-branch-access-in-rural-communities.pdf.*

itor the continued operation of these branches over the next three years as part of the FDIC's continuous examination program.[2] A failure to satisfy commitments made to the FDIC in connection with an application could give rise to adverse findings made in the examination process. In addition, as described below, the FDIC may make adverse findings and/or take appropriate enforcement action against an FDIC-supervised institution for failing to comply with the branch closing notice requirements of section 42 of the Federal Deposit Insurance Act (FDI Act).

Insured depository institutions (IDIs) must provide notice of proposed branch closings to customers and the appropriate Federal banking agency, but such closings are not subject to application requirements or regulatory approval. Section 42 of the FDI Act requires IDIs to give written notice to customers and the appropriate Federal banking agency no later than 90 days prior to the date of the proposed branch closing.[3]

Section 42 imposes additional notice requirements on interstate banks that propose to close any branch in a low- or moderate-income (LMI) area, and, under certain circumstances, authorizes the appropriate Federal banking agency to take action to convene a meeting of stakeholders in the affected area.[4] However, section 42 clarifies that such action may not affect the authority of the bank to close the branch so long as the notice requirements of section 42 are satisfied.[5] The FDIC is the primary Federal regulator for Truist and, as such, will ensure through its examination and supervisory processes that Truist satisfies the notice requirements of section 42, consistent with the Interagency Policy Statement Concerning Branch Closing Notices and Policies (Policy Statement).[6] As noted above, the FDIC may make adverse findings and/or take appropriate enforcement action against an FDIC-supervised institution for its failure to comply with the requirements of section 42.

Consistent with the Policy Statement, the FDIC will examine Truist for compliance with section 42 to determine whether it has adopted a branch closing policy and whether it has provided the required notices in connection with any applicable branch closings. In this regard the FDIC will examine Truist for compliance with section 42 just as it would with respect to any of its supervised institutions. As appropriate, the FDIC will take action to convene stakeholder meetings in connection with the proposed closings of branches in LMI areas in response to requests made in accordance with section 42.

Q.3. The FDIC's proposed rule on Federal Interest Rate Authority states that it is not based on the claimed common law "valid-when-made" doctrine, merely consistent with it.[7] In Director McWilliams' December 4, 2019, testimony before the House Financial Services Committee, however, she stated that the proposed rule is just codi-

[2] *See* Appendix A: Response to Question 2 from Ranking Member Sherrod Brown.
[3] 12 U.S.C. § 1831r–1(a)–(b). IDIs must also post a notice on the premises of a branch proposed to be closed for a period of at least 30 days prior to the proposed closing. 12 U.S.C. § 1831r–1(b)(2)(A).
[4] 12 U.S.C. § 1831r–1(d).
[5] 12 U.S.C. § 1831r–1(d)(3).
[6] *See* Branch Closings, 64 Fed. Reg. 34845 (June 29, 1999), available at *https://www.govinfo.gov/content/pkg/FR-1999-06-29/pdf/99-16471.pdf.*
[7] 84 Fed. Reg. 66845, 66848 (Dec. 6, 2019).

fying "long-standing principles." What long-standing principles is the FDIC codifying if the proposed rule is not based on "valid-when-made" doctrine?

A.3. On December 6, 2019, the FDIC published a notice of proposed rulemaking that would clarify the law governing the interest rates State banks may charge,[8] which Congress put in place for FDIC-regulated institutions in 1980.[9] This provision of the FDI Act has been interpreted in two published opinions of the FDIC's General Counsel in 1998.[10] The proposed rule would codify the guidance provided in those published opinions, which has been in effect for over 20 years. The proposal would provide that whether interest on a loan is permissible under section 27 of the FDI Act would be determined at the time the loan is made, and interest on a loan permissible under section 27 would not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan. In addition, the proposed rule is consistent with the common law "valid when made" doctrine (*i.e.,* usury must exist at the inception of the loan for a loan to be deemed usurious), which the Supreme Court has recognized for nearly 200 years.[11]

Q.4. On November 19, 2019, the FDIC announced a new rule on Federal Interest Rate Authority to "clarify the Federal law governing interest rates State-chartered banks may charge their customers."[12] As justification for the proposed rule, the FDIC claims it is necessary because of "uncertainty" created by the Second Circuit's decision in *Madden v. Midland* Funding, LLC, 786 F.3d 246 (2d Cir. 2015).[13] The proposed rule, however, only discusses potential impact of "uncertainty" does not establish that there has been any actual impact. For example, the FDIC claims in the proposed rule that "uncertainty regarding the enforceability of interest rate terms may hinder or frustrate loan sales, which are crucial to the safety and soundness of State banks" and "uncertainty has the potential to chill State banks' willingness to make the types of loans affected by the proposed rule."[14]

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[8] *See* Federal Interest Rate Authority, 84 Fed. Reg. 66845 (Dec. 6, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-12-06/pdf/2019-25689.pdf.*

[9] *See* Section 2[27(b)] of the Act of September 21, 1950 (Pub. L. No. 81–797), effective September 21, 1950, as added by section 521 of title V of the Act of March 31, 1980 (Pub. L. No. 96–221; 94 Stat. 164), effective March 31, 1980, provides that "[i]in order to prevent discrimination against State-chartered insured depository institutions, including insured savings banks, or insured branches of foreign banks with respect to interest rates, if the applicable rate prescribed in this subsection exceeds the rate such State bank or insured branch of a foreign bank would be permitted to charge in the absence of this subsection, such State bank or such insured branch of a foreign bank may, notwithstanding any State constitution or statute which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any loan or discount made, or upon any note, bill of exchange, or other evidence of debt, interest at a rate of not more than 1 per centum in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where such State bank or such insured branch of a foreign bank is located or at the rate allowed by the laws of the State, territory, or district where the bank is located, whichever may be greater."

[10] *See* FDIC General Counsel's Opinion No. 10, 63 Fed. Reg. 19258 (Apr. 17, 1998); FDIC General Counsel's Opinion No. 11, 63 Fed. Reg. 27282 (May 18, 1998).

[11] *See Nichols v. Fearson,* 32 U.S. (7. Pet.) 103, 109 (1833) ("a contract, which in its inception, is unaffected by usury, can never be invalidated by any subsequent usurious transaction"); *see also Gaither v. Farmers & Merchants Bank of Georgetown,* 26 U.S. 37, 43 (1828) ("[T]he rule cannot be doubted, that if the note free from usury, in its origin, no subsequent usurious transactions respecting it, can affect it with the taint of usury.")

[12] *https://www.fdic.gov/news/news/press/2019/pr19107.html.*

[13] *https://www.fdic.gov/news/board/2019/2019-11-19-notice-dis-c-fr.pdf.*

[14] 84 Fed. Reg. 66845, 66850 (Dec. 6, 2019).

Q.4.a. Does the FDIC have any quantifiable evidence of actual uncertainty resulting from the Second Circuit's decision in Madden? If so, please provide that evidence.

Q.4.b. Does the FDIC have any quantifiable evidence of actual impact—positive or negative—resulting from the Second Circuit's decision in Madden? If so, please provide that evidence.

A.4.a.–b. The preamble explained that an important benefit of the proposed rule is to uphold long-standing principles regarding the ability of banks to sell loans, an ability that has significant safety-and-soundness implications, and included an extensive discussion of the FDIC's legal reasoning. Further, one way the FDIC fulfills its mission to maintain stability and public confidence in the Nation's financial system is by carrying out all of the tasks triggered by the closure of an FDIC-insured institution. This includes attempting to find a purchaser for the institution and the liquidation of the assets held by the failed banks.

As it stands, the *Madden* decision could significantly impact the losses to the Deposit Insurance Fund (DIF) in a failed bank resolution and disposition of assets. Following a bank closure, the FDIC as Conservator or Receiver (FDIC–R) is often left with large portfolios of loans. The FDIC–R has a statutory obligation to maximize the net present value return from the sale or disposition of such assets and minimize the amount of any loss, both in order to protect the DIF.[15]

The DIF would be significantly impacted in a large bank failure scenario if the FDIC–R were forced to sell loans at a large discount to account for impairment in the value of those loans as a result of legal uncertainty. This uncertainty would also increase legal and business risks to potential purchasers of bank loans, which in turn would likely reduce overall liquidity in loan markets, further limiting the ability of the FDIC–R to sell loans.

The proposal also discusses concerns of market observers and ratings agencies regarding the liquidity and marketability of certain types of bank loans, and noted published research on potential effects on credit availability in the Second District.[16] The comment period closed on February 4, 2020, and the FDIC has received numerous comments expressing concerns about the potential effects on financial markets and concerns regarding availability of credit for high-risk consumers.

Q.5. You have stated that FDIC takes an "unfavorable" view of predatory rent-a-bank arrangements. If so, why has the FDIC failed to take action against Republic Bank and FinWise Bank for

[15] Federal Deposit Insurance Act (FDI Act), 12 U.S.C. 1821(d).

[16] *See* Michael Marvin, "Interest Exportation and Preemption: Madden's Impact on National Banks, the Secondary Credit Market, and P2P Lending," Columbia Law Review, Vol. 116 (January 15, 2016), available at *https://ssrn.com/abstract=2753899* (focusing on the potentially deleterious effects of Madden on credit availability and the pricing of instruments tied to debt originated by a national bank in the secondary credit market); see also Colleen Honigsberg, Robert J. Jackson Jr., and Richard Squire, "How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment," The Journal of Law and Economics 60, number four (November 2017): 673–712, available at *https://www.journals.uchicago.edu/doi/abs/10.1086/695808,* (finding that the decision in Madden not only reduced credit availability for higher-risk borrowers in the Second Circuit's jurisdiction, but affected the pricing of certain notes in the secondary market); *see also* Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy," July 5, 2018, available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208908* (finding that *Madden* led to an increase in bankruptcy rates arising predominately from changes in marketplace lending).

their rent-a-bank arrangements with Elevate Financial, and Bank of Lake Mills, Wisconsin, for its rent-a-bank arrangement with World Business Lenders, LLC?

Q.6. What is the FDIC's position on bank partnership transactions that are primarily designed to enable nonbanks to originate or purchase loans at interest rates that are illegal under State usury laws and which they could not have made themselves?

A.5.–A.6. The proposed rule affirms that the FDIC views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s). Although I am unable to address any confidential supervisory information or provide institution-specific information, I would note that the FDIC issued a public enforcement action [17] in October 2018 against Republic Bank & Trust Company for failing to clearly and conspicuously disclose required information related to the bank's Elastic line of credit product offered pursuant to a contract with Elevate@Work, L.L.C. The FDIC will continue to examine supervised institutions for compliance with all applicable laws and regulations.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR ROUNDS FROM JELENA McWILLIAMS

Q.1. As members of the Financial Stability Oversight Council (FSOC), I would like to express my gratitude for FSOC's finalization of its revised interpretive guidance on nonbank financial company designations. As the lead sponsor of the Financial Stability Oversight Council Improvement Act of 2019, I am well aware of the need to reform the process for designating financial institutions as systemically important financial institutions (SIFIs). Although no revised guidance or regulation can take the place of reforming the ill-conceived designation process that came about as a result of Dodd-Frank, I am nonetheless grateful that FSOC has taken a step to this end.

- The Financial Stability Oversight Council Improvement Act of 2019 shares many goals with the guidance. Can you expand on why you chose to prioritize an activities-based approach?

A.1. On December 30, 2019, the FSOC issued its final interpretive guidance on nonbank financial company designations, which describes the approach the Council intends to take in prioritizing its work to identify and address potential risks to U.S. financial stability using an activities-based approach.[1] This approach reflects two priorities: (1) identifying and addressing potential risks and emerging threats on a system-wide basis, thereby reducing the potential for competitive distortions among financial companies and in markets that could arise from entity-specific determinations; and (2) allowing relevant financial regulatory agencies, which generally possess greater information and expertise with respect to company,

[17] *See* FDIC Makes Public October Enforcement Actions, PR–89–2018 (November 30, 2018) available at *https://www.fdic.gov/news/news/press/2018/pr18089.html.*

[1] *See* Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, 84 Fed. Reg. 71740 (Dec. 30, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-12-30/pdf/2019-27108.pdf.*

product, and market risks, to address potential risks. The FSOC expects that, in many cases, relevant financial regulatory agencies will have authority to address risks identified by the Council under the activities-based approach.

Q.2. As one of the original sponsors of the Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings (ILLICIT CASH) Act, I am well aware of the pitfalls associated with our current anti-money laundering systems as well as the challenges that financial services institutions have in complying with current antimoney laundering rules and regulations.

Financial institutions trying to understand and comply with our existing anti-money laundering rules frequently rely on the Federal Financial Institutions Examination Council's (FFIEC) Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) Examination Manual. This manual was last updated in November 2014, before substantial changes like the finalization of the Customer Due Diligence Rule.

Q.2.a. When will the manual be updated to reflect changes made after November 2014?

A.2.a. The FFIEC released the Customer Due Diligence (CDD) and Beneficial Ownership sections of the Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) Examination Manual (Manual) on May 11, 2018.[2] These updates to the Manual were released in conjunction with the compliance date for the CDD and Beneficial Ownership rules to promote transparency in the examination process.

Currently, the FFIEC plans to release several updated sections and related examination procedures to the Manual during the second quarter of 2020. The revised sections will provide instructions to examiners for assessing banks' BSA/AML compliance programs as well as the risk assessment process. The Federal banking agencies, State banking representatives, FinCEN and the Office of Foreign Assets Control (OFAC) continue to review and revise the remaining sections of the Manual.

Q.2.b. In future updates, how will the manual promote consistency among each of the regulatory agencies that are members of the FFIEC?

A.2.b. The development of the Manual is a collaborative effort of the Federal and State banking agencies to ensure consistency in the assessment of banks' compliance with and application of the BSA/AML requirements. The FFIEC member entities are responsible for maintaining current instructions for examiners and accomplishing that objective through the Manual. Updates are completed in collaboration with FinCEN, the administrator of the BSA, and OFAC. FinCEN and OFAC contribute directly to the sections that address compliance with the regulations and sanctions programs that FinCEN and OFAC administer and enforce.

Q.3. When Congress gave the Federal Deposit Insurance Corporation (FDIC) the ability to regulate brokered deposits with the enactment of the Financial Institutions Reform, Recovery, and

[2] *See* FFIEC, "FFIEC Issues New Customer Due Diligence and Beneficial Ownership Examination Procedures" (May 11, 2018), available at *https://www.ffiec.gov/press/pr051118.htm.*

Enforcement Act of 1989 (FIRREA), there was concern about brokers moving significant amounts of unstable deposits or "hot money" from bank to bank. One key exception in FIRREA excludes certain categories of deposits like prepaid accounts from the definition of brokered deposit.

Prepaid accounts in particular were rightfully excluded from the definition of brokered deposit until 2015 when the FDIC released its Frequently Asked Questions on Brokered Deposits (FAQs). The FAQs, which were written prior to your assumption of the duties of Chairman of the FDIC, disrupted nearly 30 years of established policy regarding the treatment of brokered deposits. More specifically, the FAQs' findings that prepaid deposits are generally brokered, and the increased supervisory and deposit insurance thresholds inherent therein, are burdensome and will have the effect of both stifling innovation and limiting consumer access to these financial products.

Q.3.a. Under the FDIC's forthcoming brokered deposits rule, will a prepaid provider, fintech, or digital bank that partners with a traditional financial institution to accept deposits be considered a broker because of how they reach consumers? With the pace of innovation disrupting traditional methods of banking, many entrepreneurs partner with traditional financial institutions to expand the reach of new products and services.

Q.3.b. Lack of clarity with respect to the "primary purpose exception" could result in an unacceptable outcome in which any third-party relationship that results in a deposit could be considered brokered. This unintended outcome is particularly problematic because many innovative fintech products are structured in a similar fashion or built on similar technologies. That could, in turn, result in classifying practically all payment solutions not issued directly by a bank as brokered deposits.

- Are deposits into regulated prepaid accounts through mobile wallets brokered deposits under the FDIC's current definition?
- Will that change with the forthcoming rule on brokered deposits?

Q.3.c. As you're aware, according to the FDIC's latest National Survey of Unbanked and Underbanked Households, 6.5% of American households or about 8.4 million total households are totally unbanked while an additional 18.7% of American households or 24.2 million total households are underbanked. An overly broad definition of brokered deposits, particularly as it applies to prepaid accounts, will cause depository institutions to stop offering these products to millions of low-income consumers who find them to be helpful tools with which to manage their day-to-day banking needs.

- How will the FDIC mitigate these concerns in its forthcoming proposal?

A.3.a.–A.3.c. On December 12, 2019, the FDIC approved a notice of proposed rulemaking (NPR)[3] that would modernize its brokered deposit regulations. Among the goals of this rulemaking process are

[3] *See* Unsafe and Unsound Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf*.

to (1) develop a framework that encourages innovation, and (2) provide more clarity and consistency in what is and what is not a brokered deposit.[4] The accessibility of banking services to unbanked and underbanked populations is a key motivation of the proposal.

Under the NPR, a prepaid provider, fintech, or digital bank that partners with an insured depository institution will not be considered a deposit broker if (1) the third-party entity is not engaged in the business of placing deposits or engaged in the business of facilitating the placement of deposits, based on the criteria laid out in the proposal, or (2) the third-party entity satisfies one of the exceptions to the deposit broker definition, one of which is the primary purpose exception. The NPR proposes a new interpretation of the primary purpose exception that focuses on the business relationship between the third-party entity and its customers. In addition, in the NPR, the FDIC proposes that certain business relationships, including those in which a third-party places funds into transactional accounts to enable payments, would be deemed to meet the primary purpose exception (subject to certain criteria and an application process). My staff would be happy to discuss the proposal in further detail, and we look forward to receiving robust comments on the proposal.

Q.4. When does the FDIC intend to finalize its insured depository institution resolution planning rule? The lack of clarity about when the rule is to be finalized is problematic given that many institutions have been left wondering whether or not resolution plans will be required in 2020. The FDIC's finalization of this rule in early 2020 would leave institutions that are required to submit resolution plans with only a short amount of time to prepare.

A.4. On April 22, 2019, the FDIC issued an advance notice of proposed rulemaking (ANPR) seeking comment on potential changes to the resolution planning rule for IDIs.[5] The next step is to issue a notice of proposed rulemaking (NPR). Following the issuance of the NPR, the FDIC will provide a period of time for the public to comment, and then the FDIC will review comments prior to issuing a final rule. In connection with approving the ANPR last year, the FDIC Board voted to delay the next IDI resolution plans until the rulemaking process is completed. Once a final rule is issued, the FDIC will ensure that firms have adequate time to prepare and submit any required resolution plans.

Q.5. I've taken note of legislation introduced in the House that would preempt State legislation and impose price controls on virtually all types of consumer credit, from small dollar loans to revolving credit. This would represent an unacceptable expansion of Government control into the financial services sector that could prevent consumers from obtaining the types of products they need to establish, build, or re-build credit—including the credit card that you mentioned obtaining when you were a newly arrived immigrant in the United States.

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[4] *See* FDIC Chairman Jelena McWilliams, "Brokered Deposits in the Fintech Age," speech before the Brookings Institution (Dec. 11, 2019), available at *https://www.fdic.gov/news/news/speeches/spdec1119.html.*

[5] *See* Resolution Plans Required for Insured Depository Institutions With $50 Billion or More in Total Assets, 84 Fed. Reg. 16620 (Apr. 22, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-04-22/pdf/2019-08077.pdf.*

While I empathize with the sponsors of the House legislation in wanting to promote consumers' access to credit products that are affordable, I'm concerned that the legislation being contemplated could do the exact opposite and hurt the already underbanked and unbanked. My concern is driven particularly by a test program the FDIC ran in 2008 that studied the ability for banks to offer small dollar loans with a 36% interest rate cap. Unfortunately, banks that participated in the test found that such loans were unprofitable and thus unsustainable.

- Is capping interest rates a good idea?
- What are the consequences of the caps contemplated by the legislation I've referenced?

A.5. I defer to Congress on whether legislation should be adopted to address this matter. The FDIC is looking for ways to encourage banks to meet consumers' small-dollar credit needs in a manner that makes sense for both the bank and the consumer. The FDIC issued a request for information [6] in November 2018 to learn more about small-dollar credit needs. We received more than 60 comment letters, including a response [7] from former FDIC Chairman Sheila Bair noting that the FDIC's two-year pilot program on small-dollar lending in 2008–2009 showed that "flexibility on pricing is necessary" for short-term, small-dollar loans and that rates above 36% "may be necessary for loans of just a few hundred dollars to stimulate more competition." We are reviewing our existing guidance and considering steps to address this issue in a manner that does not limit credit availability for borrowers.

Q.6. Following up on my previous question, I understand the FDIC is participating in a forthcoming rulemaking on small-dollar lending. It's encouraging to see our regulators taking a proactive approach to extending credit to underserved consumers.

- When will your joint rule be proposed?
- Will it include a recession of the FDIC's guidance on small dollar loans that was issued in 2013?

A.6. According to the FDIC's unbanked and underbanked study, over 20 million households in America are underbanked and over 8 million are unbanked.[8] While some banks offer small-dollar lending to help those in need, many banks have chosen not to offer such products, in part, due to regulatory uncertainty [9] As a result,

[6] Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58566 (Nov. 20, 2018), available *https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf.*

[7] *https://www.fdic.gov/regulations/laws/federal/2018/2018-small-dollar-lending-3064-za04-c-049.pdf*

[8] *See* 2017 FDIC National Survey of Unbanked and Underbanked Households, available at *https://www.fdic.gov/householdsurvey/2017/2017report.pdf.* A household is classified as un banked if no one in the household has a checking or savings account. A household is classified as underbanked if it has a checking or savings account and used one of the following products or services from an alternative financial services provider in the past 12 months: money orders, check cashing, international remittances, payday loans, refund anticipation services, rent-to-own services, pawn shop loans, or auto title loans.

[9] The FDIC, FRB, and OCC have taken separate approaches to small-dollar lending at the institutions they regulate. *See* FDIC Issues Final Guidance Regarding Deposit Advance Products (Nov. 21, 2013), available at *https://www.fdic.gov/news/news/press/2013/pr13105.html;* FDIC FIL–50–2007, Affordable Small-Dollar Loan Guidelines (June 19, 2007), available at: *https://www.fdic.gov/news/news/financial/2007/fil07050.pdf;* OCC Bulletin 2018–14, Core Lending Principles for Short-Term, Small-Dollar, Installment Lending (May 23, 2018), available at: *https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html; Federal Reserve*

many families rely on nonbank providers to cover these emergency expenses, or their needs go unmet. To solicit feedback on these products and consumer needs, the FDIC issued a request for information[10] in November 2018 to learn more about small-dollar credit needs and concerns. We have reviewed more than 60 comments and are reviewing our existing policies, including the 2013 guidance on deposit advance products. On March 26, 2020, the FDIC, OCC, FRB, NCUA, and CFPB issued a statement to encourage financial institutions to offer responsible small-dollar loans to consumers and small businesses.[11] We continue working closely with the other bank regulatory agencies to coordinate policies and plan to take additional action in this area in the near future.

Q.7. South Dakotans have been closely monitoring developments in *Madden v. Midland,* including the recently released proposed rules from the FDIC and OCC that would provide additional certainty surrounding the valid-when-made doctrine. Critics of your proposal claim that it could serve as a vehicle for nonbanks to evade State interest rate caps.

- Has the FDIC discussed this scenario in the past? If so, what was the outcome?
- Does the FDIC have the legal authority necessary to prevent this from occurring?

A.7. The proposed rule affirms that the FDIC views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s). Although I am unable to address any confidential supervisory information or provide institution-specific information, I would note that the FDIC issued a public enforcement action[12] in October 2018 against Republic Bank & Trust Company for failing to clearly and conspicuously disclose required information related to the bank's Elastic line of credit product offered pursuant to a contract with Elevate@Work, L.L.C. The FDIC will continue to examine supervised institutions for compliance with all applicable laws and regulations.

RESPONSE TO WRITTEN QUESTION OF SENATOR TILLIS FROM JELENA MCWILLIAMS

Q.1. Thank you for your ongoing study of the FDIC-brokered deposit rules. As you continue to consider amendments to how these rules impact brokerage cash sweeps, can you comment on establishing a level playing field between broker-dealers affiliated with banks and brokerage firms without bank affiliates? Will these brokerage sweeps receive equal treatment under any future rule?

Statement on Deposit Advance Products (April 25, 2013), available at: https://www.federalreserve.gov/supervisionreg/caletters/caltr1307.htm.

[10] Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58566 (Nov. 20, 2018), available *https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf.*

[11] *See* FDIC FIL–26–2020, Statement Encouraging Responsible Small-Dollar Lending to Consumers and Small Businesses in Response to COVID–19 (March 26, 2020), available at: *https://www.fdic.gov/news/news/financial/2020/fil20026.pdf.*

[12] *See* FDIC Makes Public October Enforcement Actions, PR–89–2018 (November 30, 2018) available at *https://www.fdic.gov/news/news/press/2018/pr18089.html.*

A.1. On December 12, 2019, the FDIC issued a notice of proposed rulemaking[1] that would modernize its brokered deposit regulations. The proposal does not differentiate between third parties that offer cash sweep accounts that are affiliated with banks and third parties that offer cash sweep accounts that are not affiliated with banks. An entity that applied for a primary purpose exception would be analyzed based on the same criteria regardless of whether or not the entity is affiliated with a bank.

The FDIC looks forward to receiving comments on the proposal and finalizing the rule.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KENNEDY FROM JELENA McWILLIAMS

Q.1. In response to my question you noted that the FDIC regulates banks the same way it regulates ILCs. From the FDIC perspective that may be accurate, but ILCs are not subject to regulation or supervision at the parent holding company level. ILCs may be owned by a nonfinancial company not subject to the BHC Act, which introduces important policy questions. In particular, the lack of capital and liquidity standards at the holding company, no real requirements that the holding company act as a source of strength to the ILC, no ongoing supervision or regulation, and no other prudential and risk management standards applied to the holding company can really expose the financial system and Deposit Insurance Fund to risk.

a. Aside from what the FDIC does, what potential concerns do these regulatory gaps present?

b. Do you view any risks to approving ILCs that do not have a nexus to the financial services industry?

c. How does the FDIC plan to address or mitigate these risks as it considers what we understand to be a high volume of interest in potentially applying for an ILC charter?

d. What is the FDIC's plan to ensure that ILC charter applicants have robust data protection and privacy standards akin to the ones that bank holding companies are subject to?

e. What kind of governance requirements will the FDIC impose on ILC applicants for proper cyber security processes, protocols and controls?

f. What risks do commercial firms pose to the Deposit Insurance Fund?

g. Does the FDIC have sufficient personnel to supervise a potentially large platform technology firm with international operations?

h. How would the FDIC work with the State regulators or other regulators to address potential consumer risks?

A.1. Industrial loan companies (ILCs) and Industrial Banks are State-chartered, FDIC-supervised financial institutions that can be

[1] *See* Unsafe and Unsound Practices: Brokered Deposits Restrictions, 85 Fed. Reg. 7453 (Feb. 10, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-02-10/pdf/2019-28275.pdf.*

owned by financial or commercial firms.[1] Congress authorized Federal deposit insurance for ILCs and Industrial Banks in 1982,[2] and exempted ILCs and Industrial Banks from the definition of "bank" under the Bank Holding Company Act (BHCA) in 1987.[3] As of December 31, 2019, there were 23 ILCs and Industrial Banks with approximately $141 billion in aggregate total assets. These ILCs and Industrial Banks are subject to the same FDIC statutory standards as other insured depository institutions (IDIs) for which the FDIC is the primary supervisor.

In determining whether to grant deposit insurance to an ILC or Industrial Bank, the FDIC must consider the same statutory factors under section 6 of the Federal Deposit Insurance Act (FDI Act)[4] that it considers for all other applications for deposit insurance, including traditional banks: (1) the financial history and condition of the depository institution; (2) the adequacy of its capital structure; (3) future earnings prospects; (4) the general character and fitness of management; (5) the risk presented by such depository institution to the DIF; (6) the convenience and needs of the community to be served by the depository institution; and (7) whether the depository institution's corporate powers are consistent with the purposes of the FDI Act. The FDIC must also consider whether the parent company can serve as a source of strength to the IDI, as required by Section 616 of the Dodd-Frank Act.

Although a financial or commercial firm that owns an ILC or Industrial Bank is not subject to regulation or supervision by the Federal Reserve Board at the parent holding company level because of the exemption from the BHCA, an ILC or Industrial Bank is required to enter into legally enforceable commitments with the FDIC as a required condition of approval for an ILC or Industrial Bank and their parent companies. Beginning in 2000, the FDIC has required ILCs or Industrial Banks and their parent companies to enter into Capital and Liquidity Maintenance Agreements (CALMAs) and Parent Company Agreements (PAs), which have proven to be useful as part of a comprehensive supervisory strategy to protect the IDI and address potential risks to the DIF.

CALMAs are designed to ensure that the parent financially supports the IDI and serves as a source of strength in terms of capital and/or liquidity. CALMAs require that capital contributions be made in the form of cash unless other assets are approved. Liquidity provisions in a CALMA require financial support to meet any ongoing liquidity obligations, and may require the top-tier parent company to establish a line of credit on which the IDI can draw. As a general matter, ILCs and Industrial Banks have higher capital and liquidity requirements than traditional *de novo* community banks.

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[1] *See* FDIC Supervisory Insights, Supervision of Industrial Loan Companies (Summer 2004), available at *https://www.fdic.gov/regulations/examinations/supervisory/insights/sisum04/sisum04.pdf.*

[2] *See* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97–320, 96 Stat. 1469 (1982).

[3] *See* Competitive Equality Banking Act of 1987, Pub. L. No. 100–86, 101 Stat. 552 (Aug. 10, 1987).

[4] 12 U.S.C. § 1816.

PAs are designed to address a variety of circumstances regarding corporate governance and control exercised over the IDI and include consent of the nonbank parent to agree to examination by the FDIC. Among other items, PAs help ensure that the IDI's board and executive officers are independent of the parent company and any affiliates, that the IDI operates under a separate and distinct business plan, and that the IDI maintains separate books and records. The PAs also require the ILC or Industrial Bank to abide by the limitations on transactions with affiliates under Section 23A and 23B of the Federal Reserve Act and Regulation W. Further, the FDIC requires the ILC or Industrial Bank to adhere to the anti-tying requirements under the BHCA, insider lending limitations under Regulation O, and restrictions on conflicts of interest.

In addition to the requirements under the PA and CALMA, FDIC examiners conduct supervisory examinations of both the ILC or Industrial Bank focusing on safety and soundness, Bank Secrecy Act and Anti-Money Laundering (BSA/AML) compliance, information technology (including cybersecurity), and consumer protection. With regard to consumer protection, all ILCs and Industrial Banks are subject to the same consumer protection laws the FDIC supervises and enforces compliance with for all FDIC State nonmember banks.

For example, ILCs and Industrial Banks are subject to Section 5 of the Federal Trade Commission Act (FTC Act), which provides that unfair and deceptive acts and practices (UDAPs) affecting commerce are illegal.[5] Under Federal Trade Commission (FTC) and FDIC precedent, supervisory enforcement actions require companies to take reasonable and appropriate measures to protect consumers' personal data. The FTC and FDIC actions have focused on consumer deception either through false representations of data security or misappropriations of private data and failure to properly protect consumer data from data breaches. Further, the Gramm-Leach-Bliley Act (GLBA) applies to all companies that provide financial services, so if it is any type of financial service provider (which is broadly defined), it is subject to Federal privacy and data security standards. Additionally, ILCs and Industrial Banks are subject to fair lending laws, including fair credit reporting, truth in lending, and the Community Reinvestment Act (CRA).

On March 17, 2020, the FDIC Board unanimously approved a proposed rule[6] that would impose these required conditions on all future ILC applicants.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM JELENA McWILLIAMS

Q.1. Montana, and many areas of the country, face challenges of housing availability, affordability, and aging housing stock. As you know, this is a significant issue for rural as well as urban areas and is one of the largest barriers to success nationally. In Montana,

[5] *See* 15 U.S.C. § 45(a) (Section 5 FTC Act).

[6] *See* Parent Companies of Industrial Banks and Industrial Loan Companies, 85 Fed. Reg. 17771 (Mar. 31, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-03-31/pdf/2020-06153.pdf.*

lack of workforce housing is one of the greatest inhibitors of economic development.

Q.1.a. What can be done to increase workforce housing and encourage more affordable housing to be built?

Q.1.b. What do you see as the largest barrier to affordable housing, particularly in rural areas?

Q.1.c. How has the [Fed/FDIC/NCUA] worked to support housing? Where is there room for additional efforts?

A.1.a.–A.1.c. The FDIC's mission of promoting stability and public confidence in the Nation's financial system is accomplished by, among other things, encouraging financial institutions to help meet the credit needs of the communities they serve and by promoting laws, regulations, policies, and programs that protect and inform consumers. Every year, the FDIC's Community Affairs branch conducts numerous events focused on affordable mortgage lending. In 2019, FDIC Community Affairs convened, hosted, and facilitated 50 events and activities nationwide, drawing about 800 intermediaries. These events addressed Affordable Single Family Housing, Community Stabilization, Affordable Mortgage Credit, Affordable Housing (Rental and Single Family), Disaster Recovery and Rural Housing, and the Community Reinvestment Act (CRA).

In addition, FDIC Community Affairs complements the work of FDIC bank examiners and helps to enhance FDIC-supervised banks' understanding of potential CRA community collaboration opportunities related to housing. The FDIC's Affordable Mortgage Lending Center (AMLC)[1] serves as a resource for community banks. The AMLC helps banks to identify the steps necessary to expand or initiate affordable mortgage lending and compares affordable mortgage programs from Federal, State, Federal Home Loan Banks, and other sources. The AMLC is updated regularly and the number of subscribers has grown steadily with about 18,000 subscribers to date. Other FDIC venues to educate consumers on affordable mortgage lending are provided through the FDIC's free financial education curriculum Money Smart[2] and Consumer News publications, including articles for multiple consumer segments focused on home buying or renting.

Mortgage lending is an important element of many community banks' business and CRA strategies, and the FDIC aims to help strengthen the role of community banks in the affordable mortgage market by amplifying awareness of current programs and highlighting innovative practices. Examples of affordable housing efforts by FDIC Community Affairs include the following:

- The FDIC San Francisco Regional Office hosted an interagency Banker Roundtable regarding affordable housing solutions, where participants discussed strategies such as amending local policy to increase Accessory Dwelling Units and Transit Oriented Development.
- The FDIC Dallas Regional Office, along with the Oklahoma Affordable Housing Coalition, hosted five regional forums regard-

[1] *See* FDIC, Community Affairs—Affordable Mortgage Lending Center, available at *https://www.fdic.gov/consumers/community/mortgagelending/index.html.*

[2] *See* FDIC, Money Smart—A Financial Educational Program, available at *https://www.fdic.gov/consumers/consumer/moneysmart/index.html.*

ing the assessment of the affordable housing needs of each county in the State. The information gathered in these forums led to programs in targeted geographies and evolved into an annual Housing Conference where stakeholders continue to learn and collaborate to address the specific needs of their Oklahoma communities.

- The FDIC Atlanta Regional Office co-sponsored an Innovative Housing Symposium in Panama City, Florida, aimed at identifying housing strategies to retain the workforce and strengthen the housing stock.

More generally, the FDIC also addresses specific economic inclusion challenges in Indian Country, Appalachia, and rural areas and identifies opportunities for targeted resources to assist and educate Minority Depository Institutions and community banks serving rural areas and Indian Country.

Q.2. I appreciated the responses to my questions during the hearing, and the focus on supporting our farmers and ranchers and their families through the current challenges facing the agriculture sector while continuing to prioritize the safety and soundness of our community financial institutions.

Is there anything that you would like to add on this topic?

A.2. I deeply appreciate the challenging environment faced by farmers and ranchers and the community banks that serve them. The FDIC is the primary Federal regulator for most agricultural banks and thus understands these challenges firsthand. For example, between 1980 and 2010, more than half of all rural counties across the United States lost population, and the rural counties that experienced outflows lost 14.8 percent of their population on average.[3] Although community banks in depopulating areas have been resilient in meeting the challenges posed by these demographic trends, the eroding size of the local customer base makes it harder to raise deposits and attract loan customers.

The FDIC continues to focus on agricultural lending and the ability for farm banks, which represent nearly one-quarter of all FDIC-insured institutions, to manage amid changing industry conditions.[4] In June 2019, the FDIC hosted an Agriculture Banking Conference in Kansas City, which brought together regulators, bankers, policymakers, academics, and industry participants to discuss short-term risks and long-term challenges across the industry.[5] In addition, the FDIC recently issued an advisory[6] regarding the prudent management of agricultural lending during economic cycles. The FDIC will continue to engage with farm banks and other stakeholders on this issue.

Q.3. In response to my question during the hearing you included that you believe there are ways to benefit small family farms, rural

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

[4] *See* FDIC 2019 Risk Review, available at *https://www.fdic.gov/bank/analytical/risk-review/full.pdf.*

[5] *See* FDIC Agriculture Banking Conference, available at *https://www.fdic.gov/bank/analytical/ag/.*

[6] *See* FDIC FIL–5–2020, Advisory: Prudent Management of Agricultural Lending During Economic Cycles (January 28, 2020), available at *https://www.fdic.gov/news/news/financial/2020/fil20005.html.*

small businesses, rural areas, and Indian Country through increased CRA credit.

Can you expand on this?

A.3. The FDIC recognizes that small businesses, farms, and other entrepreneurs play a vital role in supporting the economic growth of rural communities. Such organizations and individuals, in turn, can only play such a role if banks lend and invest in these areas. The rule[7] recently proposed by the FDIC and OCC to modernize the CRA would incentivize greater lending and investment in areas in need of financial resources, with a particular emphasis on rural areas and Indian Country. We know that these areas often have the greatest need for financial services, and the proposal seeks to encourage banks to increase their engagement in these communities across our Nation. For example, under the proposal, the size of loans to small businesses and small farms that would qualify for CRA credit would be increased to $2 million. By increasing the loan size for small loans to farms, which was last updated 25 years ago, and increasing the revenue size threshold for small farms, the proposed rule would encourage economic development and job creation and help the U.S. agricultural industry survive. In addition, the proposal would provide CRA credit for retail and community development activities in Indian Country. The FDIC believes that these provisions will help to create greater lending and investment in these communities.

Q.4. I recently wrote to Comptroller Otting, with colleagues on this Committee, to express the importance of considering the many unique challenges in accessing financial services in rural America. It is imperative that the CRA work for communities throughout America, and that the process for potential reforms to this vital rule should reflect that. Any updates to the CRA should be done in coordination between your three agencies, and must be consistent with the original purpose of this Civil Rights-era law to bringing financial services and credit access to low- and moderate-income and underserved communities throughout our country.

As you consider changes to the Community Reinvestment Act, how are you considering and engaging rural America?

A.4. I recognize the unique challenges in accessing financial services facing many rural areas, especially given the continuing trend of depopulation that makes it more difficult for community banks headquartered in these areas to grow their balance sheets.[8] In addition, as of June 30, 2019, 620 counties—or 20 percent of the counties across the Nation—were served only by community banking offices, 127 counties had only one banking office, and 33 counties had no banking offices at all.[9]

The interagency process to modernize the CRA seeks to address the need for greater lending and investment in rural communities by incentivizing CRA activity in these areas. This process has included extensive outreach and engagement with community banks and consumers in rural America. I have personally embarked on a

[7] *See* Community Reinvestment Act Regulations, 85 Fed. Reg. 1204 (Jan. 9, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-01-09/pdf/2019-27940.pdf.*

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

[9] *See* FDIC Summary of Deposits, available at *https://www7.fdic.gov/SOD.*

50-State listening tour[10] to hear from banks directly about challenges they face and to learn about the needs of the consumers and businesses that banks serve. In my conversations with rural bankers and their customers, I have often heard concerns that the current CRA framework fails to incentivize CRA activity in many rural areas and that assessment areas have not kept pace with how consumers bank and how banking services are delivered today.

The proposal approved by the FDIC and OCC in December 2019 reflects this extensive outreach and engagement. The proposal seeks to address these concerns by encouraging banks to lend and invest in these communities across our Nation and requiring banks to add assessment areas where they have significant concentrations of retail domestic deposits. The agencies will continue to engage with all stakeholders throughout the rulemaking process.

Q.5. I would like an update on an issue I've followed and written to the Federal Reserve and FDIC about, the "covered funds" definition in the Volcker Rule. As drafted, banks are prevented from activities that they are regularly allowed to do directly on their balance sheets. Oftentimes clients, such as large pension funds, want their banks to provide long-term investments or loans in these fund structures to have some skin in the game. I continue to strongly support the Volcker Rule's purpose of preventing speculative trading that is at odds with the public interest. As your agencies continue their process here, I encourage you to work towards an outcome that allows capital for growing and innovating companies and the ability to invest in long-term investment vehicles, while keeping a focus on preventing the activities that the rule is intended to stop.

As your agencies look at the impact of rules and any potential changes, will you consider activities that are considered safe and allowable elsewhere in banks? And especially the impact on the availability of funding for companies in the middle of America looking to grow?

A.5. On January 30, 2020, the FDIC Board approved a proposed rule[11] that would amend the regulations implementing Section 619 of the Dodd-Frank Act (the Volcker Rule) by modifying and clarifying the "covered fund" provisions. Among other things, the proposal would establish a new exclusion from the covered fund definition for venture capital funds, which would allow banking entities to acquire or retain an ownership interest in, or sponsor, certain venture capital funds to the extent the banking entity is permitted to engage in such activities under otherwise applicable law. This proposed exclusion would help ensure that banking entities can fully engage in this important type of development and investment activity, which may facilitate capital formation and provide important financing for small businesses, particularly in areas where such financing may not be readily available.

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[10] *See* Transparency and Accountability—FDIC Chairman State Visits (Last Updated 02/20/2020), available at *https://www.fdic.gov/transparency/visits.html.*

[11] *See* Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 85 Fed. Reg. 12120 (Feb. 29, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-02-28/pdf/2020-02707.pdf.*

Q.6.a. Thank you all for your updated guidance on providing financial services to the hemp industry. As you know, this is an issue that has been very important to me. Montana leads the country in hemp production, and this guidance will help our producers and the financial institutions that are now able to serve them.

What will your agencies be doing to educate your examiners and the institutions that you oversee to adapt to working with hemp-related businesses?

A.6.a. In 2019, the FDIC conducted internal training for all commissioned safety and soundness bank examiners, case managers, management, and large bank staff. Among other things, the training addressed the legal status, commercial growth, and production of hemp, as well as Customer Due Diligence (CDD) requirements for hemp-related customers, which is consistent with other commercial customers. During 2019, the FDIC also provided two hemp-related informational sessions for members of the Advisory Committee on Community Banking. Those sessions were webcast and are available to augment formal examiner training. Going forward, the FDIC will continue to provide internal training that will include examiner instruction for assessing a bank's BSA/AML compliance program when providing services to hemp-related businesses.

In December 2019, the Federal banking agencies and FinCEN, in consultation with the Conference of State Bank Supervisors, issued a statement on hemp-related businesses.[12] The statement highlighted that hemp is no longer a Schedule I controlled substance under the Controlled Substances Act, and as such, banks are not required to file a Suspicious Activity Report (SAR) on customers solely because they are engaged in the growth or cultivation of hemp in accordance with applicable laws and regulations.[13] The statement also emphasized that it is generally a bank's business decision as to the types of permissible services and accounts to offer.

Q.6.b. Are there areas that you anticipate will require additional guidance?

A.6.b. I have heard about this issue during every single State visit I have made so far. I recognize that banks have been put in a difficult position between complying with Federal law and what is permissible at a State level. We understand that FinCEN may be developing more comprehensive guidance with respect to the hemp industry. We are also referring some inquiries to the U.S. Department of Agriculture (USDA) for up-to-date information regarding the national regulatory structure governing hemp growth and cultivation. The USDA issued an interim final rule in October 2019, and maintains hemp-related information on its public website. We have also referred matters to the U.S. Food and Drug Administration (FDA) when they apply to the FDA's authority (such as hemp infused "medication" or food products).

[12] *See* FDIC, "Agencies Clarify Requirements for Providing Financial Services to Hemp-Related Businesses" (Dec. 3, 2019), available at *https://www.fdic.gov/news/news/press/2019/pr19115.html.*

[13] *See* FDIC FIL–5–2015, Statement on Providing Banking Services (January 28, 2015), available at *https://www.fdic.gov/news/news/financial/2015/fil15005.html.*

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MORAN FROM JELENA MCWILLIAMS

Q.1. We've had positive Committee discussions of late about the prospect of marking up legislation on bills introduced with bipartisan support and one which I hope will fall within that category is S. 2649, dealing with the bank examination review process.

We continue to hear from community banks that the examination process is cumbersome and largely without any practical review or appeal process, with the regulators' Ombudsmen Offices often not utilized in this regard as a result. S. 2649 seeks to update this process with greater transparency and due process. Do you have any thoughts on this issue and what the FDIC is doing to improve the examination process and opportunity for meaningful review?

A.1. I recognize that the FDIC's appeals process for bank examinations can be improved, and we are actively working on this issue. The FDIC recently hosted a series of listening sessions to solicit feedback on the supervisory appeals and dispute resolution process, where we received a number of valuable suggestions.

With respect to the examination process, the FDIC has taken numerous steps to modernize its supervision and examination programs, including by leveraging technology to reduce the amount of time examination teams spend onsite at supervised institutions. This reduces the compliance burden for institutions—especially community banks—without sacrificing the quality of our supervision. As a result, our examination turnaround time (*i.e.,* the time from when field work begins to when the examination report is sent to the bank) has significantly improved. During the 12 months ended November 30, 2019, nearly 88 percent of safety and soundness examinations were conducted within our 75-day goal and 97 percent of consumer compliance and CRA examinations were conducted within our 120-day goal. Similarly, examination report processing time (*i.e.,* the time from when field work is complete to when the report is sent to the bank) has improved markedly, with nearly 93 percent of safety and soundness reports and more than 98 percent of consumer compliance and CRA reports processed within our 45-day goal.[1]

Q.2. I applaud the OCC and the FDIC for issuing proposed rules last month that would provide certainty that an interest rate that is valid when the loan is made by a bank remains valid when the loan is transferred or sold. Since the Second Circuit issued its decision in *Madden v. Midland Funding,* I have had serious concerns that the decision discourages use of loan assignments and securitization to manage liquidity and concentration risk and may decrease consumers' access to credit.

Some have criticized your action, claiming that it would permit nonbanks to evade a State's interest rate cap. I believe this criticism is without merit.

- Have you not been crystal clear that a nonbank may not partner with a bank "with the sole goal of evading a lower interest

[1] *See* FDIC Transparency & Accountability—Bank Examinations, available at *https://www.fdic.gov/transparency/examination.html.*

rate established under the law of the entity's licensing State(s)"?

- Is it not true that your agencies can use supervision and enforcement to ensure that banks do not enter into "rent-a-bank" partnerships with nonbanks with the sole goal of evading a State's interest rate cap?

A.2. The FDIC's notice of proposed rulemaking[2] published on December 6, 2019, affirms that the FDIC views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s). Although I am unable to address any confidential supervisory information or provide institution-specific information, I would note that the FDIC issued a public enforcement action[3] in October 2018 against Republic Bank & Trust Company for failing to clearly and conspicuously disclose required information related to the bank's Elastic line of credit product offered pursuant to a contract with Elevate@Work, L.L.C. The FDIC will continue to examine supervised institutions for compliance with all applicable laws and regulations.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MENENDEZ FROM JELENA McWILLIAMS

Q.1. Earlier this year, Comptroller Otting said that the Office of the Comptroller of the Currency (OCC) was taking the lead on writing a rule to rein in risky incentive-based compensation practices at large financial institutions that reward senior bank executives for irresponsible risk-taking. Additionally, at a House Financial Services Committee hearing in May, Otting said that the OCC shared its proposal with the Securities and Exchange Commission (SEC).

Chair McWilliams and Vice Chair Quarles, has Comptroller Otting shared the OCC's proposal with either of your agencies?

- If yes, what does the proposal contain?
- If yes, are all six regulators on board with the proposal?
- If yes, when can we expect to see a notice of proposed rulemaking posted?

Q.2. Have all six regulators (FDIC, Fed, NCUA, SEC, OCC, and FHFA) sat down together to discuss this rulemaking?

- If yes, when did these discussions take place?
- If yes, have all six regulators decided to move forward with a proposed rule?

Q.3. If the OCC decides to move forward on executive compensation rule without all six regulators, are you concerned the OCC will create two different standards, encouraging banks to shop for the regulator with the weakest requirements?

A.1.–A.3. In June 2010—one month prior to the enactment of the Dodd-Frank Act—the FDIC, Federal Reserve Board (FRB), Office of

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[2] *See* Federal Interest Rate Authority, 84 Fed. Reg. 66845 (Dec. 6, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-12-06/pdf/2019-25689.pdf.*

[3] *https://orders.fdic.gov/sfc/servlet.shepherd/document/download/069t00000037a32AAA?operationContext=S1.*

the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS) issued guidance to help ensure that incentive compensation policies at banking organizations do not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization.[1] Section 956 of the Dodd-Frank Act subsequently directed the FDIC, FRB, OCC, NCUA, SEC, and FHFA ("six agencies") to jointly prescribe, within nine months of the enactment of the law, regulations or guidelines that prohibit incentive-based pay arrangements that the six agencies determine encourage inappropriate risks. Section 956 mandates that the six agencies ensure that the standards are "comparable" to the standards established under section 39 of the Federal Deposit Insurance Act (FDI Act) and specifically take into consideration the compensation standards described in section 39(c). Under section 39(c), the Federal banking agencies are required to prohibit compensation arrangements that provide excessive compensation or could lead to material financial loss to an insured depository institution (IDI). Section 39(c) was promulgated by Congress in 1991 and has been in effect for IDIs since then.

While the banking agencies' 2010 guidance remains fully intact, the six agencies continue to engage in discussions regarding how best to implement the statute. In the meantime, the FDIC continues to review compensation policies and practices of supervised institutions in accordance with the FDI Act and the 2010 guidance to ensure that institutions have appropriate risk management frameworks in place, including appropriate oversight and governance by the Board of Directors and sound operational controls.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM JELENA MCWILLIAMS

BB&T–SunTrust Merger

The FDIC's Statement of Policy for merger approvals pursuant to the Bank Merger Act lists various standards that the FDIC will apply when evaluating a merger transaction.[1] While the FDIC released the Order and Basis for Corporation Approval along with the press release that the merger had been approved, the document is only 19 pages long and does not provide sufficient details warranted by a transaction that created the sixth largest commercial bank in the United States and the largest bank regulated by the FDIC.[2]

Competitive Factors

Q.1.a. The FDIC evaluated how the transaction would affect competition in 81 geographic markets.[3] These geographic markets are

[1] *See* Federal Reserve, OCC, OTS, FDIC Issue Final Guidance on Incentive Compensation (June 21, 2010), available at *https://www.federalreserve.gov/newsevents/pressreleases/bcreg20100621a.htm.*

[1] Federal Deposit Insurance Corporation, "FDIC Law, Regulations, Related Acts," *https://www.fdic.gov/regulations/laws/rules/5000-1200.html#fdic5000fdicso2.*

[2] Federal Deposit Insurance Corporation, "Order and Basis for Corporation Approval," *https://www.fdic.gov/news/news/press/2019/pr19111a.pdf.*

[3] *Id.*

the areas used to measure the concentration of the relevant banking products.

How were these geographic markets defined? Are these the same geographic market definitions that the FDIC has used in evaluating previous merger applications?

Q.1.b. Were the definitions of any predefined markets altered from the time the merger application was filed to the time of the merger approval?

Q.2. According to the Statement of Policy, the FDIC considers the extent of existing competition "in the relevant product market(s) within the relevant geographic market(s)." However, in the Approval Order, the FDIC only discussed the concentration levels of deposits, rather than the full complement of relevant product markets.

Q.2.a. What product markets did the FDIC use for its concentration analysis?

Q.2.b. For each product market, please describe the source of the data used for the analysis. If proxies or estimates were used, please specify.

Q.3. According to the Approval Order, in 14 of the geographic markets that the FDIC considered, the Herfindahl-Hirschman Index (HHI) levels for deposits would exceed one or both of the 1800/200 thresholds, meaning that the expected change in market concentration is significant.

Q.3.a. For the six markets where credit unions or thrifts mitigated the competitive concerns, please identify which credit unions and thrifts were included in the analysis, the dollar amount of their deposits, and any weights used for these institutions.

- Unlike banks and thrifts, credit unions are not required to report deposits on a branch-level. Please indicate how the FDIC obtained the deposit levels for credit union branches. If estimates were used, please describe the methodology.

Q.3.b. For the eight markets with divestitures, do any of these markets still approach either of the HHI thresholds even after considering the divestitures? If so, please indicate the geographic market and the HHI-levels before and after the merger.

A.1.a.–A.3.b. Section 18(c)(5)(A) of the Bank Merger Act (BMA) prohibits the FDIC from approving a merger transaction that would result in, or would be in furtherance of, any combination or conspiracy to monopolize or to attempt to monopolize the business of banking in any part of the United States.[4] Similarly, section 18(c)(5)(B) of the BMA prohibits the FDIC from approving a merger transaction if the effect of the proposed merger transaction in any section of the country may be to substantially lessen competition, or tend to create a monopoly, or would in any other manner be in restraint of trade, unless the FDIC finds that the anticompetitive effects of proposed transaction are clearly outweighed in the public

[4] 12 U.S.C. § 1828(c)(5)(A).

interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.[5]

Although the BMA requires the FDIC to make an independent determination on the competitive effects of a proposed merger transaction, section 18(c)(4) of the BMA directs the Attorney General of the United States to furnish to the appropriate Federal banking agency a report on the competitive factors involved in a merger transaction subject to the BMA upon the request of the FDIC.[6] The FDIC Statement of Policy on Merger Transactions states, as required by law, that the FDIC will request a report on the competitive factors involved in a proposed merger transaction from the Attorney General. This report must ordinarily be furnished within 30 days, and the applicant upon request will be given an opportunity to submit comments to the FDIC on the contents of the competitive factors report. Similarly, it is the practice of the Federal Reserve Board (FRB) to request such a report from the Attorney General in connection with bank holding company transactions subject to section 3 of the Bank Holding Company Act. Accordingly, the FDIC, FRB, and U.S. Department of Justice (DOJ) coordinated their review of the competitive effects of the proposal.[7]

Geographic Markets

It is the longstanding practice of the Federal banking agencies and DOJ to first assess the competitive effects of a proposed bank merger transaction by calculating concentration levels under the Herfindahl-Hirschman Index (HHI), a commonly accepted measure of market concentration.[8] Generally, the Federal banking agencies and DOJ view a transaction that does not result in a post-merger HHI result of more than 1800 points and an increase of more than 200 points within a geographic market as not raising competitive concerns. Transactions that exceed both thresholds typically warrant further review.

In evaluating the competitive effects of the proposal, FDIC staff, in coordination with FRB and DOJ staff, considered how the transaction would affect competition in the 81 geographic markets where both BB&T and SunTrust operate. These banking markets are subject to periodic updates, and the FDIC's competitive analysis of the transaction was based on the most recent market definitions. Although the FDIC is not bound to use these predefined markets, it is consistent with the long-standing practices of the FDIC and other Federal banking agencies and DOJ to do so, and the FDIC considers FRB-defined banking markets to be presumptively reasonable for the purposes of its competitive review of merger transactions.

[5] 12 U.S.C. § 1828(c)(5)(B).

[6] 12 U.S.C. § 1828(c)(4). *See also* FDIC, "FDIC Statement of Policy on Bank Merger Transactions," available at *https://www.fdic.gov/regulations/laws/rules/5000-1200.html.*

[7] *See* Federal Reserve and Department of Justice, "How do the Federal Reserve and the U.S. Department of Justice, Antitrust Division, analyze the competitive effects of mergers and acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners' Loan Act?" available at *https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm;* and Department of Justice, "Bank Merger Competitive Review—Introduction and Overview (1995)," available at *https://www.justice.gov/sites/default/files/atr/legacy/2007/08/14/6472.pdf.*

[8] The HHI is calculated by summing the squares of the market shares of each participant in a relevant geographic market.

Product Markets

With regard to calculating market share in the relevant product market, the FDIC (consistent with the other Federal banking agencies and DOJ), uses deposit market share based on FDIC-generated summary of deposit (SOD) data. This focus on deposits recognizes that deposits represent a proxy for the full "cluster" of banking products and services provided to households and small businesses.[9] For this reason, deposit market share guides the competitive review of bank merger transactions. The FDIC's competitive review was also informed by additional information, including business lending information, as contemplated in the "FDIC Statement of Policy on Bank Merger Transactions,"[10] as well as FRB and DOJ FAQs addressing the competitive review of merger transactions.[11]

Outcome

As noted above, a transaction that does not result in a post-merger HHI of more than 1800 points and an increase of more than 200 points within a geographic market does not generally raise competitive concerns. Using the FRB-defined markets as the relevant geographic markets, and SOD data as a proxy for the relevant product market, the FDIC found that the HHI levels in 67 of the 81 markets fell below one or both of these thresholds, and that the HHI levels in the 14 remaining markets approached or exceeded both thresholds.

In 6 of these 14 markets, the FDIC found that the presence of competitively viable credit unions mitigated the competitive concerns associated with the increased concentration levels. After incorporating such institutions into the market concentration calculations in these six markets, the FDIC found the resulting HHIs to be at acceptable levels.[12]

Consistent with the approach outlined in the FRB and DOJ FAQs, the determination of whether to include credit unions in market concentration calculations was based on whether such institutions have the capacity to exert competitive pressures on banks within the relevant market. The FDIC incorporated into its analysis those credit unions with fields of membership extending to all or almost all of a relevant market's population and that had branches easily accessible to the general public. Because credit unions do not report branch-level deposits, the FDIC approximated such deposits in each relevant market based on available data. To avoid potentially overstating the competitive power of the included

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[9] *See* FDIC, "FDIC Statement of Policy on Bank Merger Transactions," available at *https://www.fdic.gov/regulations/laws/rules/5000-1200.html.* "In many cases, total deposits will adequately serve as a proxy for overall share of the banking business in the relevant geographic market(s); however, the FDIC may also consider other analytical proxies." *See also United States v. Philadelphia National Bank,* 374 U.S. 321, 356 (1963) (holding that the relevant product market in a bank merger is the "cluster" of products and services provided by commercial banks).

[10] *Id.*

[11] *See* FRB and DOJ, "How do the Federal Reserve and the U.S. Department of Justice, Antitrust Division, analyze the competitive effects of mergers and acquisitions under the Bank Holding Company Act, the Bank Merger Act and the Home Owners' Loan Act?" available at *https://www.federalreserve.gov/bankinforeg/competitive-effects-mergers-acquisitions-faqs.htm.*

[12] These markets include North Lake/Sumter, Florida; Atlanta, Georgia; Milledgeville, Georgia; Lexington, Virginia; Norfolk-Portsmouth, Virginia; and Richmond, Virginia. Although not exceeding the HHI thresholds, staff also scrutinized the following markets and found that no additional mitigation was needed to address increased concentration: Citrus County, Florida; Daytona Beach Area, Florida; Savannah, Georgia; Lynchburg, Virginia; Newport News-Hampton, Virginia; and Winchester, VA–WV.

credit unions, the FDIC reduced the deposits attributed to the credit unions by 50 percent.

With respect to the eight remaining markets presenting heightened concentration levels, the primary mechanism to mitigate the competitive effects of the proposed merger was the divestiture of 30 SunTrust branches to a third-party acquirer. With the consummation of the divestiture and the inclusion of competitively viable credit unions, the concentration levels within the eight remaining markets result in an HHI level near or below 1800 points or an increase of fewer than 200 points.[13]

The applicants agreed to divest every SunTrust branch in the following six markets: Lumpkin County and Wayne County, Georgia; Winston-Salem, North Carolina; and Eastern Shore, Martinsville, and South Boston, Virginia. The "clean sweep" of SunTrust branches from these markets effectively neutralizes any change to the respective markets' HHIs as a result of the merger.[14] In the remaining two markets, Durham-Chapel Hill, North Carolina, and Roanoke Virginia, the applicants committed to partial divestiture of SunTrust branches. The FDIC found that the divestitures adequately mitigated the competitive effects of the proposed merger.[15] The FRB and DOJ determinations were substantially similar.

As described above, the FDIC's competitive review of the transaction was consistent with its approach to other merger transactions, and was guided by the review framework outlined in the FDIC's Statement of Policy on Bank Merger Transactions, the FRB and DOJ FAQs on merger transactions, and the DOJ's bank merger guidelines. After thoroughly reviewing the competitive effects of the merger, considering deposit concentration levels, business lending data, market dynamics in each geographic market, and the branch divestitures, the FDIC determined the merger transaction would not result in a monopoly in any part of the United States, and would not substantially lessen competition, tend to create a monopoly, or otherwise be in restraint of trade in any section of the country. This finding was consistent with the conclusions reached by the FRB in its review of the proposal under the Bank Holding Company Act, and with the concurrence of DOJ in authorizing the transaction.

Prudential Factors

Q.4. Please describe the process by which the FDIC evaluated the financial soundness of the resulting institution.

Q.5. Please describe the process by which the FDIC evaluated the management of the resulting institution.

A.4.–A.5. The FDIC has established a comprehensive risk-focused supervisory process for insured depository institutions. For large

[13] The HHI calculation in certain markets factored in additional adjustments as appropriate, such as the exclusion of certain centrally booked deposits.

[14] The HHIs in each of these six mergers exceeded 1800 HHI points on both a pre- and post-transaction basis, but the "clean sweep" of SunTrust branches in these markets result in a *de minimis* change to the total HHI.

[15] After accounting for divestiture and appropriate weightings for thrifts and credit unions, the change in HHI to the Roanoke market exceeded 200 points, but the resulting HHI in Roanoke, Virginia, was below the 1800 threshold. After accounting for divestiture, appropriate weightings for thrifts and credit unions, and adjustments for centrally booked deposits, the change in HHI in Durham-Chapel Hill, North Carolina, was less than 200 points to a level below 1800.

banks directly supervised by the FDIC, a continuous examination program is employed, whereby dedicated staff conducts on-site supervisory examinations and ongoing institution monitoring to monitor risk, assign supervisory ratings, and take other required supervisory action.

FDIC staff is also dedicated to large institutions for which the FDIC is not the primary Federal regulator, and these individuals work closely with the primary Federal regulator to identify and monitor risk. FDIC staff also conducts quarterly risk assessments of large institutions and assigns an independent rating that considers vulnerability to asset and funding stress, as well as potential loss severity. Given these well-established supervisory processes, FDIC staff had a sound understanding of both institutions' risk profiles and risk management activities prior to considering the merger application.

Analysis of Statutory Factors, Generally

In evaluating a merger transaction, section 18(c)(5) of the BMA directs the FDIC to consider the financial and managerial resources and future prospects of the existing and proposed institutions.

As noted in the FDIC's Statement of Policy on Bank Merger Transactions, the FDIC will normally approve a proposed merger transaction where the resulting institution meets existing capital standards, continues with satisfactory management, and whose earnings prospects, both in terms of quantity and quality, are sufficient. In evaluating management, the FDIC will rely to a great extent on the supervisory histories of the institutions involved and of the executive officers and directors that are proposed for the resultant institution.

The FDIC's analyses include an assessment of the overall condition of each institution involved in the proposed merger, as well as the combined financial resources. Available holding company support is also considered, as is the source of funding.

The FDIC will also assess the managerial resources, including the active management of each institution as well as the combined institution. Analyses are conducted of each institution's corporate governance practices as well as a review of managements' past responsiveness to regulatory recommendations. Any significant management changes are addressed.

Outcome

In evaluating the statutory factors, staff analyzed historical, current, and projected financial data and business models, as well as management capabilities, public comments, and other relevant matters. Both BB&T and SunTrust were in satisfactory financial condition, based on supervisory information and financial reports. Both institutions demonstrated acceptable earnings and asset quality, strong capital, and sufficient liquidity. Over the past 20 years, BB&T has reported positive annual net income every year, while over the same period SunTrust reported positive net income for every year except 2009. Additionally, the institutions were viewed to have complementary business models and to pose moderate risk, given their community focus and largely traditional business lines, which Truist Bank—the bank formed by the merger of BB&T and SunTrust—is expected to continue.

The management team has documented experience and expertise regarding large regional bank operations and has been responsive to regulatory concerns. Directors and officers have held similar positions within the respective institutions prior to the merger, and proposed management officials have been associated with these institutions for a substantial period of time.

Convenience and Needs Factor

Q.6.a. The FDIC is required by the BMA to note and consider each institution's performance under the CRA. As stated in the Approval Order, while BB&T has an outstanding record of meeting community credit needs, SunTrust has a satisfactory record.

On the same day the merger was approved, the Federal Reserve issued a consent order against SunTrust as a result of misleading or inaccurate statements to business customers about the operation and billing of certain add-on products.

Did the FDIC consider the compliance records of both entities with respect to consumer finance laws in their review of the merger? Did the FDIC consult with the CFPB or look at CFPB examination data to determine whether the banks had adequate records of compliance with consumer protection laws?

Q.6.b. At what point in the merger review process did the FDIC become aware of the practices that led to the Federal Reserve consent order against SunTrust? How were they discovered?

A.6.a.–A.6.b. In evaluating a merger transaction, section 18(c)(5) of the BMA directs the FDIC to consider the convenience and needs of the community to be served. In addition, the CRA requires that, when evaluating a BMA application, the FDIC take into account the CRA records of the institutions involved in the transaction.

The FDIC considered the CRA and compliance record of both institutions. As stated in the Order and Basis for Corporation Approval,[16] the FDIC took "into account Truist Bank's branch distribution, the CRA record of performance for BB&T and SunTrust, the commitments articulated in the applicants' Community Benefits Plan, public comments received on the Application, the consumer compliance records of both banks, and the products and services to be provided by Truist Bank."

Throughout the application review process, the FDIC was in contact with the Consumer Financial Protection Bureau (CFPB) regarding both institutions' compliance records and with the FRB regarding SunTrust's compliance record.

The FDIC became aware of the issues set forth in the FRB's Consent Order early in the application review process. The agencies had ongoing discussions regarding the substance and status of the FRB's review and, as a condition of approval of the application, the applicants agreed that Truist Bank will take all necessary and appropriate action to fully and timely comply with the Consent Order

[16] *See* FDIC, "Branch Banking and Trust Company, Winston-Salem, North Carolina, Application for Consent to Merge with SunTrust Bank, Atlanta, Georgia, and to Establish Associated Branches," available at *https://www.fdic.gov/news/news/press/2019/pr19111a.pdf*.

issued by the FRB on November 19, 2019, against SunTrust Bank, Atlanta, Georgia.

Financial Stability Factor

Q.7. The Approval Order states that "Though Truist Bank would be among the largest insured depository institutions in the United States, the proposed merger would effectuate such an increase in size by combining into one large institution products, services, and interconnections that do not generally present financial stability risks."

- Countrywide was a $200 billion institution when it failed.[17] Washington Mutual was $307 billion.[18] Together, they had the potential to do significant damage to the deposit insurance fund. Why does the FDIC believe that the failure of a $450 billion institution would not present risks to the financial system?
- Please describe the extent to which the FDIC considered the cost of failure of the merged institution in its review. How would Truist be wound down if it failed?

Q.8. The Approval Order also listed five quantitative metrics considered when evaluating the financial stability factor, including interconnectedness and complexity. For each metric, please indicate if the FDIC has established numeric thresholds to evaluate whether or not it is triggered. If so, please identify the thresholds. If not, please describe how those factors were evaluated?

A.7.–A.8. The Dodd-Frank Act amended the BMA to require the FDIC, in assessing a proposed merger transaction, to consider the risk to the stability of the United States banking or financial system.[19] However, the Dodd-Frank Act did not prescribe any specific metrics or standards to be used in consideration of this statutory factor. Rather, the drafters of the law left it to the discretion of the Federal banking agencies to use appropriate and relevant metrics and standards based on the agencies' significant supervisory experience.

In evaluating the potential impact of the proposed transaction on the stability of the U.S. banking or financial system, the FDIC considered quantitative and qualitative metrics, each of which aims to assess whether Truist Bank's systemic footprint would be such that its failure or financial distress would compromise the overall stability of the U.S. banking or financial system. In developing the financial stability analysis used for evaluating the merger transaction, the FDIC took into consideration related initiatives on financial stability of the FDIC and the other Federal banking agencies to the extent appropriate.

The quantitative metrics considered with respect to the transaction include: (1) the size of Truist Bank; (2) the availability of substitute providers for any critical products and services to be offered by Truist Bank; (3) the degree of interconnectedness of Truist

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[17] New York Times, "Bank of American to buy Countrywide," Gretchen Morgenson and Eric Dash, January 11, 2008, *https://www.nytimes.com/2008/01/11/business/worldbusiness/11iht-bofa.3.9157464.html.*

[18] Reuters, "WaMu is largest bank failure," Elinor Comlay and Jonathan Stempel, *https://www.reuters.com/article/us-washingtonmutual-jpmorgannews1/wamu-is-largest-u-s-bank-failureidUSTRE48P05I20080926.*

[19] Pub. L. No. 111–203, § 604(f), 124 Stat. 1376, 1602 (2010).

Bank with the U.S. banking or financial system; (4) whether Truist Bank would contribute to the complexity of the U.S. banking or financial system; and (5) the extent of cross-border activities of Truist Bank. No "bright line" thresholds have been established. Rather, all factors are considered individually and in the aggregate with respect to the particular facts and circumstances of the proposed transaction, with no single factor being determinative or carrying greater weight than another. The following summarizes the FDIC's approach to evaluating each of these factors:

- *Size of the Resulting Institution:* The distress or failure of an insured depository institution is more likely to negatively impact the banking or financial system if its activities comprise a relatively large share of system-wide activities. In the case of Truist Bank, the FDIC concluded that, although Truist Bank would be the sixth largest insured depository institution in the United States, its share of system-wide activities would be comparable to that of its regional bank peers, and would be significantly less than that of Global Systemically Important Banks (G–SIBs).
- *The Availability of Substitute Providers for any Critical Products and Services:* The purpose of considering the availability of substitute providers for any critical products and services to be supplied by the resulting institution is to assess the degree to which market participants rely on those products and services, to determine those products and services for which there are no ready substitutes, and to understand where an inability or unwillingness by the resulting institution to continue providing those products or services could be disruptive to the U.S. banking or financial systems.
- *Interconnectedness of the Resulting Institution with the Banking or Financial System:* The purpose of considering interconnectedness is to assess the degree to which the resulting institution may be engaged in transactions with other financial system participants and the risk that these interconnections could affect the stability of the U.S. banking or financial systems.
- *Resulting Institution Contribution to the Complexity of the Financial System:* This factor focuses on the degree to which the complexity of an institution's product offerings, activities, practices, or structure could contribute to, or transmit, risk to the U.S. banking or financial systems.
- *Cross-Border Activities:* The purpose of considering cross-border activities is to assess the degree to which coordination of the resulting institution's supervision and resolution could be complicated by differing legal requirements, geopolitical events, or competing national interests, leading to increased potential for spillover effects.

Additionally, a qualitative assessment of potential resolution-related complexities was considered, including: the resulting institution's organizational structure; challenges regarding operational continuity if a bridge bank should be necessary; saleability and separability in resolution; and potential resolution-related challenges associated with its holdings of uninsured deposits.

In factoring in the cost of a potential failure of the resulting institution, the FDIC notes that it has several powers and tools to effectively resolve failed banks. The precise resolution strategy and tools chosen for any bank failure depend upon the circumstances present at the time of failure.

Additionally, the passage of the Federal Deposit Insurance Corporation Improvement Act (FDICIA) in 1991 requires that the FDIC choose the method which is the least costly option to the Deposit Insurance Fund when resolving a failing financial institution.

The Dodd-Frank Act amended the Federal Deposit Insurance Act by adding the systemic risk exception to authorize, subject to certain requirements, other approaches to resolution if the least cost requirements of FDICIA would have serious adverse effects on economic conditions or financial stability.

Transparency

While the FDIC Policy Statement does not contain an explicit transparency requirement, you have placed a significant emphasis on transparency during your year-and-a-half at the FDIC.

Q.9. The depository data used for the anticompetitive analysis is nonconfidential information. Please provide the full anticompetitive analysis it undertook when reviewing the merger?

Q.10. During a speech at the 2019 Bank Policy Institute conference, you stated that BB&T and SunTrust made it "very difficult to decline their merger."[20] Please clarify why you found it "very difficult" to decline the merger.

Q.11. On November 19, 2019 at 10:00 am, the FDIC held a Board meeting in which they considered a variety of matters in an open session. Later that day, it was revealed that the FDIC Board approved the merger in a closed session, despite the fact that this action was creating the largest FDIC-supervised institution and is the largest bank merger since the 2008 financial crisis.

- Why was the merger considered under a closed session?
- Was any confidential information discussed during the closed session?
- Who was in attendance during the closed session? Please include Board members and non-Government officials, if applicable.
- Please provide a transcript of the closed meeting.

Q.12. American Banker published an interview with the top executives of BB&T and SunTrust in which Truist's chairman and CEO, Kelly King stated, "I was told by several senior regulators there was no legal reason to object to the deal."[21]

- Were you one of those senior level regulators?

[20] Tweet by Victoria Guida, November 20, 2019, *https://twitter.com/vtg2/status/1197213714488811520.*

[21] American Banker, "Truist rising: With mega merger done, pressure to deliver," Paul Davis, December 9, 2019, *https://www.americanbanker.com/news/truist-rising-with-mega-merger-done-pressure-on-to-deliver.*

- Did any FDIC staff have conversations with the executives, or their representatives of either institution before the merger application was filed?
  - If so, please disclose the date, participants, and substance of the conversation.
  - Did the FDIC provide any comment regarding the likelihood of the approval of the deal?

A.9.–A.12. The FDIC's competitive analyses utilized a variety of public data sources, including SOD data, but was also informed by additional data sources that represent institution-specific sensitive, confidential business and supervisory information that the FDIC does not disclose.

It is customary for the FDIC Board to consider applications, including merger applications, in closed session. The consideration of such applications often includes the discussion of institution-specific sensitive, confidential business and supervisory information that the FDIC does not disclose.

The FDIC's long-established standards regarding disclosure of information are embodied in Part 309 of the FDIC's Rules and Regulations, which provides that the FDIC will disclose final opinions, including concurring and dissenting opinions, as well as final orders and written agreements made in the adjudication of cases. The FDIC has publicly released the final order associated with the subject bank merger application.

Part 309 also provides that certain records are exempt from disclosure, including records containing or related to:

- Trade secrets and commercial or financial information obtained from a person that is privileged or confidential;
- Interagency or intra-agency memoranda or letters that would not be available by law to a private party in litigation with the FDIC; and
- Examination, operating, or condition reports prepared by, on behalf of, or for the use of the FDIC or any agency responsible for the regulation or supervision of financial institutions.

With regard to cited statements regarding the lack of a basis for denying the application, the BMA directs the FDIC to consider specific statutory factors when evaluating a merger application. To the extent that the particular facts and circumstances of a particular application lead to a favorable finding on all of these specific statutory factors, there would be no basis on which to deny the application under the BMA. Because BB&T satisfied specific statutory requirements, the FDIC application was approved unanimously by the FDIC Board. Subsequently, the FRB unanimously approved the holding company application.

Prior to the public announcement, BB&T management communicated with FDIC staff and management (as primary Federal regulator of the bank) on several occasions to provide notice that the proposed transaction would be announced in the near future. The contacts involved management and staff of the FDIC's Atlanta Regional Office, which is assigned primary supervisory responsibility for BB&T, and the FDIC's Washington Office. Specifically, from

February 1, 2019, until the proposal was publicly announced on February 7, 2019, the following contacts took place:

- On February 1, 2019, BB&T Chairman and Chief Executive Officer (CEO) Kelly King informed Chairman Jelena McWilliams by telephone that BB&T would contact FDIC staff regarding a possible merger transaction.
- On February 2, 2019, BB&T Chief Risk Officer (CRO) Clarke Starnes emailed FDIC staff to request a meeting on February 4, 2019.
- On February 4, 2019, CRO Starnes met with the FDIC's Examiner-In-Charge (EiC) of BB&T and other agency representatives, and provided notification of the proposed merger.
- On February 4, 2019, Doreen Eberley, Director of the FDIC's Division of Risk Management Supervision, spoke with BB&T Chairman and CEO King.
- On February 6, 2019, CRO Starnes emailed the FDIC's EiC of BB&T regarding the proposed announcement date.

Valid-When-Made-Doctrine

Q.13. Under current law, is a payday lender able to issue a loan with a 160 percent APR and sell that loan to a bank to avoid certain State interest rate caps?

Q.14. Under the proposed rule, would a payday lender be able to issue a loan with a 160 percent APR and sell that loan to a bank to avoid certain State interest rate caps?

Q.15. The proposal states that the FDIC would unfavorably view the practice of a nonbank lender using banks for the purpose of avoiding State interest rate caps. Please describe what concrete protections the proposed rule contains to ensure that this practice does not occur.

Would the FDIC pursue enforcement actions against banks that assist nonbank lenders in avoiding State interest rate caps?

A.13.–A.15. On December 6, 2019, the FDIC published a notice of proposed rulemaking that would clarify the law governing the interest rates State banks may charge.[22] The proposed rule would provide that whether interest on a loan is permissible under section 27 of the Federal Deposit Insurance Act would be determined at the time the loan is made, and interest on a loan permissible under section 27 would not be affected by subsequent events, such as a change in State law, a change in the relevant commercial paper rate, or the sale, assignment, or other transfer of the loan.

The proposed rule affirms that the FDIC views unfavorably entities that partner with a State bank with the sole goal of evading a lower interest rate established under the law of the entity's licensing State(s). Although I am unable to address any confidential supervisory information or provide institution-specific information, I would note that the FDIC issued a public enforcement action[23]

[22] *See* Federal Interest Rate Authority, 84 Fed. Reg. 66845 (Dec. 6, 2019), available at *https://www.govinfo.gov/content/pkg/FR-2019-12-06/pdf/2019-25689.pdf.*

[23] *See* FDIC Makes Public October Enforcement Actions, PR–89–2018 (November 30, 2018), available at *https://www.fdic.gov/news/news/press/2018/pr18089.html.*

in October 2018 against Republic Bank & Trust Company for failing to clearly and conspicuously disclose required information related to the bank's Elastic line of credit product offered pursuant to a contract with Elevate@Work, L.L.C. The FDIC will continue to examine supervised institutions for compliance with all applicable laws and regulations.

Q.16. The proposed rule does not contain a single quantitative estimate to estimate the impact of the change on consumers. The rule explicitly claims that "in jurisdictions affected by Madden, to the extent the proposed rule results in the preemption of State usury laws, some consumers may benefit from the improved availability of credit from State Banks. For these consumers, this additional credit may be offered at a higher interest rate than otherwise provided by relevant State law."

- Is the FDIC conducting a quantitative cost-benefit analysis to evaluate the costs of loans being offered at higher interest rates against the benefit of these loans being available?
- Has the FDIC conducted any cost-benefit analysis to justify the proposed rule? If not, what is the justification for moving forward with the proposed rule if the FDIC "is not aware of any broad effects on credit availability as a result of Madden," as stated in the proposal?

A.16. The preamble explained that an important benefit of the proposed rule is to uphold longstanding principles regarding the ability of banks to sell loans, an ability that has significant safety-and-soundness implications, and included an extensive discussion of the FDIC's legal reasoning. Further, one way the FDIC fulfills its mission to maintain stability and public confidence in the Nation's financial system is by carrying out all of the tasks triggered by the closure of an FDIC-insured institution. This includes attempting to find a purchaser for the institution and the liquidation of the assets held by the failed banks.

As it stands, the *Madden* decision could significantly impact the losses to the DIF in a failed bank resolution and disposition of assets. Following a bank closure, the FDIC as Conservator or Receiver (FDIC–R) is often left with large portfolios of loans. The FDIC–R has a statutory obligation to maximize the net present value return from the sale or disposition of such assets and minimize the amount of any loss, both in order to protect the Deposit Insurance Fund (DIF).[24]

The DIF would be significantly impacted in a large bank failure scenario if the FDIC–R was forced to sell loans at a large discount to account for impairment in the value of those loans as a result of legal uncertainty. This uncertainty would also increase legal and business risks to potential purchasers of bank loans, which in turn would likely reduce overall liquidity in loan markets, further limiting the ability of the FDIC–R to sell loans.

The proposal also discusses concerns of market observers and ratings agencies regarding the liquidity and marketability of certain types of bank loans, and noted published research on potential

[24] Federal Deposit Insurance Act (FDI Act), 12 U.S.C. 1821(d).

effects on credit availability in the Second District.[25] The comment period closed on February 4, 2020, and the FDIC has received numerous comments expressing concerns about the potential effects on financial markets and concerns regarding availability of credit for high-risk consumers.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CORTEZ MASTO FROM JELENA MCWILLIAMS

Q.1. This spring, the Office of Management and Budget issued a memorandum that for the first time required independent regulatory agencies such as yours to submit final rules to the Administration before publishing them.

- Did the FDIC get approval from OMB for any of your final rules or guidance—Volcker rule, alternative data, real estate appraisals, community bank leverage ratio, *etc.*? If so, which rules were submitted?
- Did OMB make any changes to your rule? If so, what changes did OMB request?

A.1. The FDIC will continue to meet its statutory mission as an independent regulatory agency while abiding by all applicable laws, including the requirements set forth by Congress under the Congressional Review Act. As required under the Congressional Review Act, the FDIC has historically submitted and continues to submit final rules published in the *Federal Register* to the Office of Management and Budget (OMB). The FDIC has been evaluating whether other documents meet the definition of a rule under the Congressional Review Act, in which case such documents will be submitted to OMB and to Congress, as required under the Congressional Review Act. For example, the FDIC recently submitted to OMB and to Congress an advisory regarding the prudent management of agricultural lending during economic cycles.[1] The FDIC continues to review whether additional principles should be adopted to improve transparency and accountability to Congress with respect to the rulemaking process.

Q.2. Without the Community Reinvestment Act, the homeownership rate in our country, and especially for Latinos and African Americans, would be much lower. UnidosUS published a report, Latino Homeownership 2007–2017: A Decade of Decline for Latinos, which found that that the CRA helped facilitate between

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[25] *See* Michael Marvin, "Interest Exportation and Preemption: Madden's Impact on National Banks, the Secondary Credit Market, and P2P Lending," Columbia Law Review, Vol. 116 (January 15, 2016), available at *https://ssrn.com/abstract=2753899* (focusing on the potentially deleterious effects of *Madden* on credit availability and the pricing of instruments tied to debt originated by a national bank in the secondary credit market); *see also* Colleen Honigsberg, Robert J. Jackson Jr., and Richard Squire, "How Does Legal Enforceability Affect Consumer Lending? Evidence from a Natural Experiment," The Journal of Law and Economics 60, number four (November 2017): 673–712, available at *https://www.journals.uchicago.edu/doi/abs/10.1086/695808,* (finding that the decision in *Madden* not only reduced credit availability for higher-risk borrowers in the Second Circuit's jurisdiction, but affected the pricing of certain notes in the secondary market); *see also* Piotr Danisewicz and Ilaf Elard, "The Real Effects of Financial Technology: Marketplace Lending and Personal Bankruptcy," July 5, 2018, available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3208908* (finding that *Madden* led to an increase in bankruptcy rates arising predominately from changes in marketplace lending).

[1] *See* FDIC FIL–5–2020, Advisory: Prudent Management of Agricultural Lending During Economic Cycles (January 28, 2020), available at *https://www.fdic.gov/news/news/financial/2020/fil20005.html.*

15% to as much as 35% of home loans to Latinos. How would proposed changes to CRA close the racial and ethnic homeownership gap?

A.2. On December 12, 2019, the FDIC and the Office of the Comptroller of the Currency (OCC) approved a notice of proposed rulemaking[2] that would modernize the regulations implementing the CRA, which have not been substantively updated for nearly 25 years. The proposed rule is intended to increase bank activity in low- or moderate-income (LMI) communities where there is significant need for credit, encourage more responsible lending, and promote improvements to critical infrastructure. The proposal, like the existing rules, continues to evaluate banks on the 18 mortgage loans made to LMI individuals. The proposal sets forth numerous questions on ways in which the rule can be improved.

The proposal would (1) clarify and expand what qualifies for CRA credit, (2) expand where CRA activity counts; (3) provide an objective method to measure CRA activity; and (4) revise data collection, recordkeeping, and reporting requirements.

With respect to the first set of changes, the proposal would establish clear criteria for the type of activities that qualify for CRA credit, require the agencies to publish periodically an illustrative list of examples of qualifying activities, and establish a process for banks to seek agency confirmation that an activity is a qualifying activity. These changes would address current impediments to engaging in CRA activities and provide banks with greater certainty and predictability regarding whether certain activities qualify for CRA credit. Specifically, by providing banks with greater confidence that activities qualify for CRA credit before they invest time and resources in those activities, the proposed rule would incentivize banks to more readily engage in innovative projects that have a significant impact on the community. Moreover, by allowing stakeholders to confirm that activities qualify, the proposal would eliminate the uncertainty in the current regulations that potentially limited the scope and type of banks' CRA activities that will benefit banks' communities, particularly LMI individuals and areas.

In addition to providing transparency, the proposed qualifying activities criteria would expand the types of activities that qualify for CRA credit to recognize that some banks are currently serving community needs in a manner that is consistent with the statutory purpose of CRA but are not receiving CRA credit for those activities. This expansion would ensure that banks help meet the needs of their entire communities, particularly LMI neighborhoods and other areas and populations of need. The expanded qualifying activities criteria would focus on economically disadvantaged individuals and areas in banks' communities. For example, the proposed qualifying activities criteria would expand the activities that qualify in areas that have traditionally lacked sufficient access to financial services, such as (1) distressed areas; (2) underserved areas, including areas where there is a great need for banking activities but few banks that engage in activities (known as banking deserts);

[2] *See* Community Reinvestment Act Regulations, 85 Fed. Reg. 1204 (Jan. 9, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-01-09/pdf/2019-27940.pdf.*

and (3) Indian country. Moreover, to maintain a focus on LMI individuals, the proposal would, for example, no longer permit a mortgage loan to a high-income individual living in a low-income census tract to qualify for CRA credit.

As with any comprehensive set of reforms, the agencies rely on stakeholder feedback. The agencies will continue to engage with regulated institutions, community and consumer groups, members of Congress, and other stakeholders through the rulemaking process, including with respect to the issue of homeownership rates.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAMER FROM JELENA MCWILLIAMS

Q.1. The FDIC is the largest regulator of community banks. These institutions would not be in business if they are not serving their community. What steps are you considering in the CRA modernization process to ensure that the burden of regulatory change for community banks will not be disproportionate to the benefits of updated regulations?

A.1. On December 12, 2019, the FDIC and the Office of the Comptroller of the Currency (OCC) approved a notice of proposed rulemaking [1] that would modernize the regulations implementing the CRA, which have not been substantively updated for nearly 25 years. The proposed rule is intended to increase bank activity in low- or moderate-income (LMI) communities where there is significant need for credit, encourage more responsible lending, and promote improvements to critical infrastructure. The proposal would ensure that small banks are not overly burdened by the need to overhaul their existing systems or collect and report extensive data to comply with the new framework. Specifically, the proposal would allow small banks (*i.e.,* those with $500 million or less in total assets) to choose to be evaluated under the current rules or to opt in to the new performance standards.

Moreover, the proposal would add a criterion for activities that help finance or support another bank's community development (CD) loans, CD investments, or CD services. Including this criterion and expanding the definition of CD loan and investments to include certain commitments to lend and invest would address the fact that community banks understand community needs best but often are unable to provide the necessary funding or service alone. In these cases, large banks may finance the project, benefiting from community banks' efforts to identify areas of need. This criterion would address stakeholders' recommendations that the CRA regulatory framework do more to encourage inter-bank collaboration and allow community banks to remain involved in projects that they identified and enabled.

Q.2. I appreciate that the FDIC and OCC have publicly encouraged banks to expand their small-dollar lending. I understand—and appreciate—that the Fed, FDIC and OCC are working together on a regulatory action that would remove barriers that discourage banks

[1] *See* Community Reinvestment Act Regulations, 85 Fed. Reg. 1204 (Jan. 9, 2020), available at *https://www.govinfo.gov/content/pkg/FR-2020-01-09/pdf/2019-27940.pdf.*

from entering or deepening their presence in the market for small dollar credit.

- What is your timeframe for issuing a regulatory action on small dollar lending?
- In conjunction with that effort, does the FDIC plan to rescind the FDIC's 2013 guidance that imposed prescriptive underwriting expectations on small dollar loans?

A.2. According to the FDIC's unbanked and underbanked study, over 20 million households in America are underbanked and over 8 million are unbanked.[2] While some banks offer small-dollar lending to help those in need, many banks have chosen not to offer such products, in part, due to regulatory uncertainty.[3] As a result, many families rely on nonbank providers to cover these emergency expenses, or their needs go unmet.

To solicit feedback on these products and consumer needs, the FDIC issued a request for information[4] in November 2018 to learn more about small-dollar credit needs and concerns. We have reviewed more than 60 comments and are reviewing our existing policies, including the 2013 guidance on deposit advance products. As you note, we are working closely with the OCC and Federal Reserve Board (FRB) to coordinate policies and plan to take action in the near future. While the interagency process for joint rulemakings and guidance documents takes longer to complete than if one agency acted alone, the FDIC's engagement with the OCC and FRB is based on an understanding that the three agencies are committed to act as expeditiously as the process would allow.

Q.3. This Committee is considering legislation that would aim at providing some regulatory certainty to banks working with cannabis-related companies in the 47 States that have taken various steps towards legalization. Would legislation such as the SAFE Banking Act be a constructive step toward providing a framework for financial institutions to serve companies that comply with State cannabis laws?

A.3. As part of my commitment to travel to every State to meet with bankers, their customers, and State regulators, I have repeatedly heard concerns regarding the uncertainty in providing banking services to cannabis-related businesses as well as other businesses that provide services to those cannabis-related businesses. The

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[2] *See* 2017 FDIC National Survey of Unbanked and Underbanked Households, available at *https://www.fdic.gov/householdsurvey/2017/2017report.pdf.* A household is classified as unbanked if no one in the household has a checking or savings account. A household is classified as underbanked if it has a checking or savings account and used one of the following products or services from an alternative financial services provider in the past 12 months: money orders, check cashing, international remittances, payday loans, refund anticipation services, rent-to-own services, pawn shop loans, or auto title loans.

[3] The FDIC, FRB, and OCC have taken separate approaches to small-dollar lending at the institutions they regulate. *See* FDIC Issues Final Guidance Regarding Deposit Advance Products (Nov. 21, 2013), available at *https://www.fdic.gov/news/news/press/2013/pr13105.html;* FDIC FIL–50–2007, Affordable Small-Dollar Loan Guidelines (June 19, 2007), available at: *https://www.fdic.gov/news/news/financial/2007/fil07050.pdf;* OCC Bulletin 2018–14, Core Lending Principles for Short-Term, Small-Dollar, Installment Lending (May 23, 2018), available at: *https://www.occ.gov/news-issuances/bulletins/2018/bulletin-2018-14.html;* Federal Reserve Statement on Deposit Advance Products (April 25, 2013), available at: *https://www.federalreserve.gov/supervisionreg/caletters/caltr1307.htm.*

[4] Request for Information on Small-Dollar Lending, 83 Fed. Reg. 58566 (Nov. 20, 2018), available at *https://www.govinfo.gov/content/pkg/FR-2018-11-20/pdf/2018-25257.pdf.*

Financial Crimes Enforcement Network (FinCEN) issued guidance in 2014 to address the Bank Secrecy Act obligations when serving these customers.

While financial institutions say they understand FinCEN's guidance, the guidance addresses BSA obligations and does not address uncertainty related to law enforcement. I defer to Congress on how best to address this uncertainty.

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

Q.1. Please provide to the Committee a detailed list of all meetings with individuals or groups not directly affiliated with the agency you serve, from May 15, 2019 to present.

A.1.:

May 15, 2019—Wednesday

- Senate Hearing—Committee on Banking, Housing, and Urban Affairs "Oversight of Financial Regulators"

May 16, 2019—Thursday

- Committee on Financial Services Hearing "Oversight of Prudential Regulators: Ensuring the Safe, Sound, and Accountable Conduct of Megabanks and Other Depository Institutions"

May 20, 2019—Monday

- Otoe-Missouria FCU Charter Ceremony, Red Rock, OK

May 22, 2019—Wednesday

- Meeting with Andrew Moss, OCC, Outreach and External Relations Program Manager—MDI
- Andrew Young Presents: The Color of Money—OCC

May 29, 2019—Wednesday

- Phone call with—Andrew Moss, Outreach and External Relations Program Manager, OCC

May 30, 2019—Thursday

- Lunch Meeting with CFPB Director Kraninger
- FSOC Principles Meeting—Treasury

May 31, 2019—Friday

- Remarks before the Hope Global Forum—Atlanta, GA

June 3, 2019—Monday

- Federal Reserve Bank of Atlanta Meeting (Dr. Raphael Bostic)—Atlanta, GA
- Federal Home Loan Bank of Atlanta Meeting—Atlanta, GA

June 4, 2019—Tuesday

- Meet—Cities for Financial Empowerment Fund—CFE Fund, NYC

June 5, 2019—Wednesday

- HSBC Financial Innovation Center Meeting with Jeremy Balkin—HSBC Midtown Office

- Adam Connaker—Rockefeller Foundation Center for Innovation

June 6, 2019—Thursday
- Inclusiv Meeting with Cathie Mahon—NYC
- Meeting with National Urban League President Marc Morial—NUL Headquarters

June 7, 2019—Friday
- Geopolitics of Cyber Technology Breakfast Briefing—Deutsche Bank Innovation Lab

June 10, 2019—Monday
- FFIEC Briefing with Secretary Judy Dupree, Kaelin Browne, and Rosanna Piccirilli
- Credit Union National Association (CUNA) Meeting—CUNA Office DC

June 11, 2019—Tuesday
- Fintech Meeting with Jeff Bandman, Bandman Advisors
- Cato Institute Call with Moderator
- Media Training Beverly Hallberg, District Media Group

June 12, 2019—Wednesday
- CATO Summit on Financial Regulation Fire Side Chat—Cato Institute
- Meet with Jovita Carranza Treasurer—Treasury

June 13, 2019—Thursday
- Criminal re-entry event—White House
- Meeting with NWCUA's Troy Stang—City Center—DC

June 17, 2019—Monday
- Interagency Principals +1 BSA Meeting / Follow-Up Law Enforcement Briefing—Treasury
- Virginia ARP (VA ARP) Meeting

June 18, 2019—Tuesday
- Meeting with National Disability Institute—Michael Morris and Mark Richert (Director of Public Policy)
- Farm Credit Administration Meeting with Board Member and Acting CEO Jeff Hall and his EA Kevin Kramp

June 19, 2019—Wednesday
- Exchequer Club Meeting Luncheon—Mayflower Hotel

June 20, 2019—Thursday
- Maryland/DC Credit Union Association Meet and Greet
- Cooperative Credit Union Association Meet and Greet
- Meeting with State Employees CU CEO, Mike Lord

June 21, 2019—Friday
- NEC Meeting

June 25, 2019—Tuesday
- Cybersecurity Threat Monitoring, Tools & Resources—Workshop—Interagency MDI & CDFI Bank Conference—FDIC

- Interagency MDI & CDFI Bank Conference Reception—FDIC

June 27, 2019—Thursday
- FFIEC Principles Meeting—Consumer Financial Protection Bureau
- Ceremonial Swearing In by Vice President Pence-Eisenhower Executive Office Building

July 9, 2019—Tuesday
- CNBC's Capital Exchange: The Economy 2020—AJAX DC
- Meeting with former Comptroller Tom Curry, currently at Nutter
- Meeting with Stephanie Ortoleva—Founding President and Executive Director, Women Enabled International

July 10, 2019—Wednesday
- Meeting with Larry Blanchard
- Meeting with National Association of Credit Union Service Organizations (NACUSO)
- Meeting with Navy FCU President/CEO Mary McDuffie

July 11, 2019—Thursday
- Ja'Ron Smith—Director of Urban Affairs and Revitalization at Executive Office of the President—White House
- PALs Group Meeting with Lauren Saunders, Michael Calhoun, Chris Peterson, Rob Randhava

July 12, 2019—Friday
- FFIEC Conference Call—FFIEC Appraisal Subcommittee

July 15, 2019—Monday
- Lunch Meeting with HUD Secretary Carson—U.S. Department of Housing and Urban Development
- Cooperative Credit Union Alliance

July 17, 2019—Wednesday
- Meeting with Boyce Adams, Banktel Systems
- Meeting with Senator Crapo

July 18, 2019—Thursday
- Grand Opening of Hope Inside Destinations Credit Union—Baltimore, MD

July 19, 2019—Friday
- Media Training with Beverly Hallberg

July 22, 2019—Monday
- Small Business Matters Summit

July 23, 2019—Tuesday
- Interagency Principals +1 BSA Meeting—OCC

July 24, 2019—Wednesday
- PEW Meeting—Chairman to call in
- Carolinas Credit Union League Meet & Greet—Columbia, SC

- Dinner with League members after Meet & Greet in SC

July 25, 2019—Thursday
- Carolinas Credit Union League—North Carolina Meet & Greet—Raleigh, NC

July 26, 2019—Friday
- National Urban League Conference—IN

July 27, 2019—Saturday
- 2019 National Urban League Small Business Matters Summit "How to Become Bankable" Workshop—IN
- National Urban League Small Business Matters Entrepreneurship Summit—National Urban League (Panel)—IN

July 29, 2019—Monday
- Lunch with the Indiana League—IN

July 31, 2019—Wednesday
- Meeting with Mark Zelden—The Center for Faith and Opportunity Initiatives, Department of Labor
- Meeting with Andrew Giuliani, White House Office of Public Liaison

August 1, 2019—Thursday
- Call with Anthony Hernandez (Defense Credit Union Council)
- Victoria Guida—Politico

August 2, 2019—Friday
- David Baumann—CU Times
- John Reosti—CU Journal
- Ray Birch—CU Today

August 6, 2019—Tuesday
- Meeting with Jerry Buckley—Buckley LLP

August 7, 2019—Wednesday
- Meet and Greet—UNC Center for Community Capital—North Campus

August 8, 2019—Thursday
- African American Credit Union Coalition (AACUC) Roundtable with NCUA Chairman Hood—AACUC—Charlotte, NC

August 9, 2019—Friday
- Chairman—Speaker at African American Credit Union Coalition Conference—Charlotte, NC
- CUNA Podcast On-site at African American Credit Union Coalition—Charlotte, NC
- African American Credit Union Coalition—Receptions (2) and Awards Dinner—Charlotte, NC

August 12, 2019—Monday
- Meeting with Provident CU—Redwood City, CA
- Meeting at Provident CU w/ CA League—Redwood City, CA
- Meeting with Robinhood Financial LLC—Menlo Park, CA

- Dinner with Peter Shiner—Menlo Park, CA

August 13, 2019—Tuesday
- Meeting with SF Fed Reserve—Gerry Tsai (Fintech Team)—Federal Reserve Bank of SF
- VISA Meeting—Innovation Lab—San Francisco, CA
- Brief call with Treasurer Jovita Carranza
- FHLB of San Francisco Meeting and Dinner—San Francisco, CA

August 14, 2019—Wednesday
- National Association of State Credit Union Supervisors (NASCUS) Speech—San Francisco, CA
- Brief Meeting with Katie Averill (Iowa Regulator)

August 15, 2019—Thursday
- Asian Real Estate Association of America Advisory Council Meeting—Chairman Speaks—Sonoma, CA
- Asian Real Estate Association of America Board Retreat—Chairman—Sonoma, CA
- Call with Bimal Patel Assistant Secretary for Financial Institutions at U.S. Department of the Treasury

August 16, 2019—Friday
- Call Chris Pilkerton, Acting Administrator, SBA
- Meeting with Self-Help Credit Union—Napa, CA
- Self-Help—Lunch with Steve Zuckerman and leadership team

August 20, 2019—Tuesday
- Chairman Speaking—Defense Credit Union Council Annual Conference—Chicago, IL
- Defense Credit Union Council 20th Annual Hall of Honor Awards Dinner—Chicago, IL

August 21, 2019—Wednesday
- Meet with South Side Community FCU—Chicago, IL

August 28, 2019—Wednesday
- WSJ Interview Prep with Beverly Hallberg
- Phone interview with Lalita Clozel, Wall Street Journal

August 29, 2019—Thursday
- Taped TV Interview with The Armstrong Williams Show
- White House Digital Meeting—White House

August 30, 2019—Friday
- Call with Patrick La Pine, Southeastern Credit Unions
- Dinner with Bogdon Chmielewski, Polish Credit Union CEO and Zbigniew Rogalski, Maspeth Branch Manager—NYC

August 31, 2019—Saturday
- Meeting and Brief Tour of Exhibit with Krzysztof Matyszczyk, Chairman of the Board; Bogdon Chmielewski, Polish Credit Union CEO and Maciej Golubiewski, Consul General of Poland in NYC—NYC

- Opening of “Fighting and Suffering. Polish Citizens during World War II” Exhibit (Chairman giving remarks)—NYC
- Lunch with Representatives of the Polish and Slavic FCU Board of Directors, Supervisory Committee and Executive Management—NYC
- Call to Daniel Schline, North Carolina/South Carolina League President, re: Tropical Storm Dorian

September 3, 2019—Tuesday

- Interagency Principals Law Enforcement Briefing by FinCEN—FinCEN

September 4, 2019—Wednesday

- FSOC Meeting—Treasury Department

September 5, 2019—Thursday

- Lunch Meeting with Undersecretary Mandelker—Treasury
- Phone call with Clark Akers, Hall Capital
- Meeting with Emory Cox, National Economic Council

September 9, 2019—Monday

- Chairman speaking to Truliant Federal Credit Union—DC
- Meeting with and remarks 11 Presidents of Federal Home Loan Banking System—DC

September 10, 2019—Tuesday

- Chairman Speaking to National Association of federally Insured Credit Unions Congressional Caucus—DC
- Meeting with Mick Mulvaney, Acting Chief of Staff to President Trump—DC
- In-person interview with Melissa Angell, CU Journal (immediately following NAFCU speaking)
- Meeting with John Fenton, CEO of Affinity FCU (+ 4)—DC
- Interagency Conference Call re: Model Risk Management
- Meeting with Kinecta Federal Credit Union Board’s Supervisory Committee—DC

September 11, 2019—Wednesday

- Lunch with Bimal Patel, Assistant Secretary of Treasury for Financial Institutions—Treasury Department
- Dinner with State Liaison Committee of the FFIEC—DC

September 12, 2019—Thursday

- FFIEC Principals Meeting—CFPB
- Lunch with CFPB Director Kathy Kraninger—FDIC
- Meeting with New Mexico Credit Union Hike the Hill Group

September 13, 2019—Friday

- Lunch with Rebekah Goshorn Jurata, Special Assistant to the President for Financial Policy—White House
- Phone interview with Caroline Hudson, Charlotte Business Journal

September 16, 2019—Monday

- Coffee with former Acting Comptroller Julie Williams, Promontory Financial Group—DC

September 17, 2019—Tuesday
- Meeting with Credit Union Association of the Dakotas Hike the Hill Group

September 18, 2019—Wednesday
- BSA Principals Meeting—OCC

September 19, 2019—Thursday
- Meeting with Kentucky Credit Union League and Cooperative Credit Union Association (Delaware, Massachusetts, New Hampshire, Rhode Island)
- Meeting with Cornerstone Credit Union League (Texas, Arkansas, Oklahoma)
- Meeting with Northwest Credit Union Association
- Reception: NeighborWorks Celebrates 40 Years of Community Partnerships, Investments & Impact—DC

September 20, 2019—Friday
- Australia State Arrival Ceremony—White House

September 23, 2019—Monday
- Chairman Speaking at American Credit Union Mortgage Assoc. (ACUMA) Annual Meeting—Gaylord National Harbor, MD
- Meeting with James Schenck, President/CEO, Alicia Nealon, VP of Compliance and Derrick Harris, SVP of Branch Operations, PenFed
- Meeting with Loretta Harrington, World Institute of Disability
- Meeting with New York Credit Union Association Hike the Hill Group

September 24, 2019—Tuesday
- Meeting with SchoolsFirst Federal Credit Union Hike the Hill Group
- Meeting with Montana Credit Union League
- Meeting with Congressman Ted Budd
- Evening of Conversation with Scott Pelley, CBS News, 60 Minutes and Lonnie Bunch, Secretary, National Museum of African American History and Culture—DC

September 25, 2019—Wednesday
- Meeting with the West Virginia Credit Union League & Ohio Credit Union League Hike the Hill Groups

September 26, 2019—Thursday
- America's Credit Union Museum Open House (Chairman making brief remarks)—Manchester, NH

September 27, 2019—Friday
- Phone call with Grovetta Gardineer, Senior Deputy Comptroller for Bank Supervision Policy, OCC

- Lunch with Mark Calabria, Director, FHFA—FHFA Headquarters

October 1, 2019—Tuesday
- Meeting with Mick Mulvaney, Acting Chief of Staff to President Trump—White House
- Lunch with Howard Adler, Deputy Assistant Secretary, FSOC, Treasury—DC

October 3, 2019—Thursday
- Chairman Speaking—National Council of Firefighter Credit Unions Inc. (NCOFCU) 2019 Annual Firefighters Credit Union Conference—Clearwater Beach, FL
- Dinner with Alabama Credit Union CEOs—Birmingham, AL

October 4, 2019—Friday
- Meeting with Bill Connor and America's First Federal Credit Union—Birmingham, AL
- Lunch with former NCUA Chairman Dennis Dollar, Dollar Associates—Birmingham, AL
- Meeting with Alabama Credit Union League—Birmingham, AL

October 8, 2019—Tuesday
- Chairman Hood Speaking to State Employees' Credit Union 2019 Annual Meeting—Greensboro, NC

October 11, 2019—Friday
- Phone Call—Under Secretary Sigal Mandelker, Treasury Department

October 15, 2019—Tuesday
- Radio Interview with David Webb, Webb Media
- Lunch with Kristan Nevins, Cabinet Secretary for President Trump—White House
- Meeting with James Williams, CFO, Department of Labor

October 16, 2019—Wednesday
- Meeting with Michigan Credit Union League Hike the Hill Group
- Meeting with Heartland Credit Union Association (Kansas and Missouri)
- Lunch with Nick Owens, Magnolia Strategy Partners
- Meeting with John Ryan and Mike Stevens, Conference of State Bank Supervisors

October 28, 2019—Monday
- Bite of Reality Financial Education Program—Monterey, CA
- Meeting with Diana Dykstra, CEO, California/Nevada Credit Union Leagues—Monterey, CA
- Chairman Hood Speaking to REACH 2019 Conference—Monterey, CA
- REACH Welcome Reception—Monterey, CA

October 29, 2019—Tuesday

- Lunch with California/Nevada League Credit Union CEOs—Monterey, CA

October 30, 2019—Wednesday

- Meeting with David Kimball, CEO; Usama Ashraf, CFO; David Staley, VP Capital Markets; Prosper Fintech Team along with Peter Shiner of B.R. & Co.—San Francisco, CA
- Dinner with Peter Shiner of B.R. & Co.—San Francisco, CA

October 31, 2019—Thursday

- Meeting with Google Product Team; Venkat Rapaka, Felix Lin and Noah Richmond—Google, Sunnyvale, CA
- Meeting with Google Legal and Compliance Teams; Paul Twarog, Laura Fragomeni and Noah Richmond—Google, Sunnyvale, CA
- Small Lunch Roundtable Discussion with Chairman Hood; Junior staff members from the product, legal and compliance—Google, Sunnyvale, CA
- Tour of Google X—Google, Mountain View, CA

November 1, 2019—Friday

- Meeting with Jacob Whitish, Vice Consul, Trade and Investment Officer, U.K.'s Department for International Trade—San Francisco, CA

November 5, 2019—Tuesday

- Meeting with Tim Moyer, FBI, re: money laundering and terror finance
- Meeting with Tony Ferris, GRC Revolutionist
- Meeting with Senate Majority Leader Mitch McConnell

November 6, 2019—Wednesday

- Chairman Speaking to The America Saves Summit: Attacking the Savings Crisis hosted by the Consumer Federation of America—DC

November 7, 2019—Thursday

- Reception Honoring Sigal Mandelker, U/S for the Office of Terrorism and Financial Intelligence, Treasury Department—Treasury Department
- Phone call with Secretary Ben Carson
- FSOC Meeting—Treasury Department

November 8, 2019—Friday

- Chairman touring Samsung Innovation Center
- Reid Temple Small Business Symposium (Chairman giving opening remarks and then participating in panel)—Reid Temple Church, MD

November 12, 2019—Tuesday

- Videoconference with CUNA Small Credit Union Committee
- Phone call with Congressman Trey Hollingsworth
- Meeting with Jay Clayton, Chairman, SEC

November 13, 2019—Wednesday

- Chairman Speaking to CT NASCUS Executive Forum—Hartford, CT
- Meeting/Tour with Dean Marchessault, President, CEP, American Eale Financial Credit Union with Jorge Perez, Commissioner of Financial Institutions (CT)—Hartford, CT

November 14, 2019—Thursday

- Meeting with Calvin Harris, COO, National Urban League—NYC

November 15, 2019—Friday

- Meeting with Matt Homer, Executive Deputy Superintendent, Research & Innovation Division at New York State Department of Financial Services—NYC
- FIRREA Principals Conference call

November 18, 2019—Monday

- Lunch with Debbie Matz, Former Chairman, NCUA—Alexandria, VA
- Phone call with Jelena McWilliams, Chairman of the Federal Deposit Insurance Corporation

November 19, 2019—Tuesday

- Meeting with Michelle Bowman, Governor, Federal Reserve Board
- Meeting with Emily Hollis, ALM First and Kevin Kirksey, Principal, Strategic Solution Group
- Phone call with Mike Morial, President and CEO, National Urban League
- Dinner with Leo Tilman, Tilman and Company

November 21, 2019—Thursday

- Meeting with NAFCU's Board of Directors
- Meeting with Paul Compton, General Counsel, HUD
- Phone interview with Ben Eisen, Wall Street Journal

November 25, 2019—Monday

- Remarks at Allegacy FCU High School Branch Opening—Carver High School, Winston Salem, NC
- Phone call with former SEC Commissioner Mike Piwowar and Dianna Dunne, Milken Institute

November 26, 2019—Tuesday

- Visit to Charlotte Business Journal

November 27, 2019—Wednesday

- Chairman Speaking to Charlotte Executive Club November Meeting—Charlotte, NC

December 3, 2019—Tuesday

- Meeting with Sen. Joe Manchin
- Meeting with Sen. Jon Tester

December 4, 2019—Wednesday

- House Financial Services Committee Hearing—Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions
- FSOC Meeting—Open Meeting—U.S. Department of the Treasury
- FSOC Reception hosted by Chairman Clayton and Chairman McWilliams

December 5, 2019—Thursday

- Banking Committee Hearing—Oversight of Financial Regulators

December 6, 2019—Friday

- Follow-up phone call with Tony Ferris, Rochdale Group

December 9, 2019—Monday

- Chairman Speaking to FHLB Atlanta Credit Union Conference (Keynote speaker)—Naples, FL

December 10, 2019—Tuesday

- Recording The CU Insight Experience Podcast
- Meeting with Doug Webster, Department of Labor
- Exchequer Club Holiday Reception
- Institute of International Finance Holiday Reception

December 11, 2019—Wednesday

- Phone call with Dan Newberry, Sr. VP of Lending, TTCU Federal Credit Union
- Meeting with Justin Bis—White House, Office of Presidential Personnel

December 12, 2019—Thursday

- Meeting with Congressman Blaine Luetkemeyer
- FHLB Holiday Event

December 13, 2019—Friday

- Phone call with Richard Hunt, Consumer Bankers Association
- FFIEC Principles Meeting
- White House Christmas Reception

Q.2. On October 23, 2019, I sent you a letter raising concerns that your recent actions put the NCUA's statutorily required political independence at risk, to which I have not received a response. On December 3, 2019, I received a hand delivered letter from you that summarized your accomplishments from the year, but was not responsive to my October letter. Please include for the record the responses to the five questions I asked in my October 23, 2019, letter.

A.2. The December 3, 2019, letter's purpose was to highlight accomplishments since my tenure at the NCUA. The letter also offered my availability to set up a time to discuss the questions outlined in your October 23, 2019, letter.

Q.3. The NCUA delayed for the second time an October 2015 rule to improve the resilience of the credit union system by strengthening capital requirements. In the wake of the 2008 financial crisis, credit union failures required billions of dollars in emergency liquidity assistance and Government guarantees. Many of these failures resulted from inadequate levels of capital relative to the risk associated with the credit unions' assets and operations.[1] The NCUA Board, by a 2–1 vote, has extended until January 1, 2022, the effective date of the risk-based capital rule—a rule that had an initial effective date of January 1, 2019, and that the NCUA has already expanded and delayed once before. The NCUA determined that a 2-year delay would pose incremental risk to the Share Insurance Fund. Please provide the analysis used to determine the incremental risk to the Share Insurance Fund. What is the difference in the amount of loss-absorbing capital at credit unions under the current PCA framework compared to what it would be under the risk-based capital framework?

A.3. The enhancement of the risk-based capital standards would represent just one element of the NCUA's examination and supervision program. The strength of the current economy and the strong capital position of the vast majority of federally insured credit unions allowed the agency to conclude that the incremental risk posed by a 2-year extension of the effective date is manageable. The delay will enable the agency to ensure the rule is implemented in a well-integrated way.

As part of the extensive analysis of the capital in the credit union system that agency staff performed prior to the Board's approving the 2-year extension to the risk-based capital rule, the NCUA identified credit unions that would have a capital shortfall under the rule and determined the incremental risk to the National Credit Union Share Insurance Fund was $43 million as of December 31, 2018. This estimate represents the gap between maintaining a well-capitalized classification under the current Prompt Corrective Action structure and a well-capitalized position under the future risk-based capital structure. The potential failure of these institutions during the 2-year period is mitigated by current economic conditions and other tools available under the agency's examination and supervision program.

In December 2017, the Congressional Budget Office issued a report that included the gross cost to the Share Insurance Fund related to implementation of the risk-based capital rule would be $1.2 billion over a 10-year period. Straight-lining this over a 10-year period results in an incremental cost of $120 million a year. Using this incremental loss factor for 2 years would total $240 million. Stated another way, the CBO concluded that the incremental cost represents about two basis points related to the Share Insurance Fund's equity ratio, which currently stands at 1.37 percent.

The NCUA's risk-based capital requirements will only apply to federally insured credit unions with assets greater than $500 million. Based on September 30, 2019, Call Report data, these credit unions hold $136,825,595,187 in total capital. The current minimum capital requirement for these credit unions totals $85,209,522,143. By comparison, the estimated minimum capital required for the same federally insured credit unions under the risk-based capital rule would be $85,816,494,855.

[1] 80 Fed. Reg. 66625, 66630 (Oct. 29, 2015).

Q.4. The NCUA also approved a 2018 proposal to weaken protections for payday alternative loans (PALs). In your remarks at your ceremonial swearing-in, you described how the credit union system allowed loans to be provided to members "based on the consideration of their character, as well as the ability to repay."[2] Under the final PALs II rule, however, certain loans could have triple digit APR and there is no underwriting requirement. Please explain whether credit unions are required to provide loans to members based on their ability to repay under PALs II and how the NCUA plans to examine for safety and soundness and consumer protection if credit unions are not subject to ability-to-repay underwriting requirements.

A.4. The NCUA adopted two Payday Alternative Loan rules designed to encourage credit unions to offer credit services to underbanked segments of society. The consumer protections for PALs II loans are, in fact, stronger than those for PALs I loans. The PALs II rule provides the same consumer protections that exist for PALs I loans, with the added protection to prohibit fees for overdrafts and insufficient funds.

Credit unions cannot charge an interest rate higher than 28 percent on an annualized basis for any PALs loan product. The only fee credit unions can charge in connection with making any PALs loan is an application fee in the amount of the actual cost to process an application, not to exceed $20. By definition, under Regulation Z, an application fee is not a finance charge included in the calculation of APR.[1]

[1] A Federal credit union can also charge late fees for payments a member fails to pay on time. Like application fees, late charges are not a finance charge or included in the APR.

While the PALs I and PALs II loan requirements do not prescribe a full underwriting regimen, both rules require credit unions that make PALs loans to implement "appropriate written underwriting guidelines to minimize risk, such as, requiring a borrower to verify employment by providing at least two recent pay stubs." The PALs II rule contains guidance on creating successful PALs programs that recommends adopting procedures and features designed to help each member repay these loans and restore a strong financial footing. First and foremost, the credit union should consider how the PALs loan will benefit a member's financial wellbeing. The rule also suggests including a savings component, financial education, and reporting repayment performance to consumer reporting agencies.

PALs II is a reflection of our experience overseeing the original PALs program and of working with consumer focused leaders such as Pew Charitable Trusts to craft financial solutions that make a difference to millions of Americans with low-incomes. PALs is a program of prudent lending that directly helps households who have to date been relegated to the high interest rate, subprime payday lending industry. The NCUA is committed to building on our experience in this area and adjusting this program in a way

[2] Chairman Rodney E. Hood Ceremonial Swearing-In Remarks with the Vice President, June 2019, *https://www.ncua.gov/newsroom/speech/2019/chairman-rodney-e-hood-ceremonial-swearing-remarks-vice-president.*

that helps credit unions maximize sustainable and affordable service to their members.

NCUA staff will review small-dollar lending, including PALs programs, during all safety and soundness examinations performed in 2020. The reviews will include ensuring compliance with all PALs requirements and determining whether a credit union's program meets the annual percentage rate cap.

Q.5. On December 12, 2019, the Administration approved its 2020 budget despite bipartisan concerns from both Board Member Harper and Board Member McWatters that the agency needs additional resources allocated to consumer protection and consumer compliance staff to proactively prepare for risk. Please explain why the NCUA did not include these allocations in its 2020 budget. How does the NCUA, an agency charged with ensuring that credit unions serve their members, expect to prioritize consumer protection without the appropriate level of resources?

A.5. NCUA, like all other Federal banking agencies, employs a risk-focused approach when reviewing for compliance with consumer financial protection laws and regulations. This allows our staff to focus their attention to areas of highest concern. NCUA examiners use a variety of resources to properly scope their reviews of consumer compliance, including the results of any fair lending exams and consumer compliance data. In addition, field staff annually conduct targeted reviews of significant consumer protection laws and regulations during all safety and soundness examinations. At the conclusion of an examination, field staff assign a final risk rating of high, medium, or low to assess a credit union's overall compliance risk. The risk rating typically reflects the level of compliance risk in either a component rating on Management, in a credit union's overall CAMEL rating, or both. While this compliance risk rating is not a numerical rating of 1–5 typically assigned by other Federal banking regulators, NCUA employs the same principles and compliance risk indicators as the other regulators do when assigning its compliance risk rating.

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

Q.1. As members of the Financial Stability Oversight Council (FSOC), I would like to express my gratitude for FSOC's finalization of its revised interpretive guidance on nonbank financial company designations. As the lead sponsor of the Financial Stability Oversight Council Improvement Act of 2019, I am well aware of the need to reform the process for designating financial institutions as systemically important financial institutions (SIFIs). Although no revised guidance or regulation can take the place of reforming the ill-conceived designation process that came about as a result of Dodd-Frank, I am nonetheless grateful that FSOC has taken a step to this end.

The Financial Stability Oversight Council Improvement Act of 2019 shares many goals with the guidance. Can you expand on why you chose to prioritize an activities-based approach?

A.1. In December, FSOC members unanimously approved new interpretive guidance on how the Council would designate a nonbank financial company as "systemically important." The activities-based approach ensures that the Council is looking at the widest range of potentially problematic financial activities that could threaten market stability, thus enhancing FSOC's overall vigilance and effectiveness.

This new process will also enhance the Council's engagement with the primary financial regulators, who are most knowledgeable about the activities and overall risk profiles of the entities they regulate. It also requires a quantifiable cost-benefit analysis be conducted.

The new guidance puts a premium on FSOC's transparency by laying out the exact process the Council would follow to designate a nonbank company for enhanced supervision. As such, it will provide the market with much-needed clarity on the Council's deliberations and decisionmaking.

Q.2. As one of the original sponsors of the Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings (ILLICIT CASH) Act, I am well aware of the pitfalls associated with our current anti-money laundering systems as well as the challenges that financial services institutions have in complying with current anti-money laundering rules and regulations.

Financial institutions trying to understand and comply with our existing anti-money laundering rules frequently rely on the Federal Financial Institutions Examination Council's (FFIEC) Bank Secrecy Act (BSA)/Anti-Money Laundering (AML) Examination Manual. This manual was last updated in November 2014, before substantial changes like the finalization of the Customer Due Diligence Rule.

Q.2.a. When will the manual be updated to reflect changes made after November 2014?

A.2.a. The NCUA and the other FFIEC member agencies have been working jointly to update the manual. The agencies are close to releasing a partial update to the manual, with plans to finish a full update by the end of 2020.

Q.2.b. In future updates, how will the manual promote consistency among each of the regulatory agencies that are members of the FFIEC?

A.2.b. Just as we do with the current manual, the NCUA will conduct examinations consistent with the updated manual and train staff accordingly. The updated manual will ensure the exam approach is fully risk-based, as outlined in the July 2019 Joint Statement on the Risk-Focused Approach to BSA/AML Supervision.

Q.3. I understand the National Credit Union Administration (NCUA) is preparing to release a rule that would allow for-profit investors to invest in credit unions through subordinated debt. How does allowing for-profit investment comport with credit unions' tax-exempt status?

A.3. Congress authorized secondary capital for low-income credit unions, the outstanding amounts of which are in the form of subordinated debt, to any nonnatural person investor, both for-profit and not-for-profit. On January 23, 2020, the NCUA Board unanimously approved a proposed rule that would expand the eligible investor base to accredited investors and remains consistent with the existing statutory authority. These debt instruments are nonvoting and extend no control to the investor, and therefore do not change the cooperative, not-for-profit structure of credit unions.

Q.4. The NCUA has diverged from the other members of the FFIEC recently in regulatory issues such as real estate appraisals and capital standards. I'm concerned that differing standards among peer institutions could lead to systemic risk.

Q.4.a. How do you justify these differences?

A.4.a. The Federal Credit Union Act requires the NCUA Board to prescribe, by regulation, a system of Prompt Corrective Action that is:

(1) "consistent with" § 216 of the Act; and

(2) *"comparable"* to the system of PCA prescribed in the Federal Deposit Insurance Act.[1]

The Act also requires the NCUA Board to take into account the cooperative character of credit unions when designing the PCA system. Congress specifically listed the traits of the cooperative character as the fact that credit unions are not-for-profit cooperatives that do not issue capital stock, must rely on retained earnings to build net worth, and have boards of directors that consists primarily of volunteers. These traits accurately identify the important differences between credit unions and other U.S. depository institutions. Other than these traits, credit unions face the same financial and operational risks as other federally insured depository institutions.

The Credit Union Membership Access Act of 1998 added to the Federal Credit Union Act a requirement for the NCUA to implement a risk-based net worth (risk-based capital) requirement for "complex" credit unions. While the other banking agencies' capital regulations apply to all banks regardless of size or complexity, the Federal Credit Union Act directs the NCUA to apply the risk-based requirement only to those credit unions the NCUA Board defines as complex.

Because of the requirement for the NCUA's PCA system to be comparable, and the fact that credit unions are exposed to credit risk like all depository financial institutions, the NCUA's general approach was to defer to the capital treatment used by the other Federal banking agencies and the Basel Committee on Banking Supervision.

However, the NCUA tailored the risk weights in the rule for certain assets that are unique to credit unions or where a demonstrable and compelling case exists, based on contemporary and sustained performance differences, to differentiate for certain asset classes, such as consumer loans, between banks and credit unions or where a provision of the Act requires doing so. In the instances

[1] Although the Act does not define the term "comparable," Senate Report 105–103 (May 1998) that accompanied the Credit Union Membership Access Act defines it as "parallel in substance (though not necessarily identical in detail) and equivalent in rigor."

where the risk weights are higher for credit unions, primarily concentrations of real estate and commercial loans, they relate to sources of higher losses to the Share Insurance Fund.

Thus, the rule fundamentally maintains equal treatment for equal risks in all federally insured depository institutions. This provides equivalent protection to the taxpayer across federally insured financial institutions and minimizes any competitive distortions that could result from significantly different capital requirements for particular asset classes.

In regards to appraisal standards, the NCUA Board approved an increase in the threshold below which appraisals would not be required for commercial real estate transactions from $250,000 to $1 million. This change became effective on October 22, 2019. The NCUA last increased the commercial real estate appraisal threshold in 2002. We note that, in 1994, other members of the Federal Financial Institutions Examination Council established a threshold of $1 million for certain real estate-secured business loans (qualifying business loans or QBLs). In 2019, the other members of the FFIEC raised the threshold for non-QBLs from $250,000 to $500,000.

Unlike the other banking agencies, the NCUA has never made the distinction between QBLs and non-QBLs. All commercial real estate loans, regardless if they are QBLs or non-QBLs, are subject to the same commercial loan requirements, including the $1 million appraisal threshold. Qualifying business loans are business loans that are not dependent on the sale of, or rental income derived from, real estate as the primary source of repayment. In contrast, non-QBLs are dependent on the sale or rental income derived from real estate as the primary source of repayment. Based on our supervisory experience, we believe the risks associated with QBLs and non-QBLs are different, but one is not necessarily higher risk than the other. Commercial real estate loans make up only 4 percent of credit union assets (as of 12/31/2018 Call Report data), and approximately a quarter of these commercial real estate loans would meet the definition of a QBL. For these reasons, we do not believe they warrant the added complexity of differing thresholds in our appraisal regulation.

We do not believe that increasing the threshold for commercial real estate transactions represents a threat to the safety and soundness of credit unions due to several mitigating factors. Under the Federal Credit Union Act, most credit unions are subject to a statutory ceiling (1.75x net worth) for member business loans (commercial real estate loans are a type of MBL). Therefore, increasing the threshold to $1 million does not pose the same safety and soundness risk to credit unions as it would for banks, which do not have the same commercial lending restrictions.

Transactions below the threshold are not exempt from valuation requirements altogether, as they must obtain a written estimate of market value unless specifically exempted. A valuation conducted consistent with safe and sound practices provides a reasonable basis to assess a property's market value. Although the commercial real estate appraisal threshold has increased, credit unions have always had—and will continue to have—the option to require an appraisal even when not required by regulation.

We believe that cashflow and the resiliency of the borrower are the primary determinants of the success of a loan and not the appraisal. In 2017, we enhanced our commercial lending regulation with principles-based requirements that instill appropriate discipline for commercial lending at credit unions. For these reasons, we do not believe that raising the commercial real estate appraisal threshold will pose a significant risk to the safety and soundness of the credit union system.

Q.4.b. How do the NCUA and FFIEC work together?

A.4.b. The NCUA is an active participant of the FFIEC, and I currently serve as the Council's Vice Chairman. The agency is represented on various task forces, sub-committees, and working groups. Through these efforts, the NCUA works closely with the other FFIEC members to develop and promote uniform principles and standards related to the examination and supervision program. Additionally, the agencies develop, provide, and receive training through the FFIEC. While each agency must tailor practices, regulations, and supervisory processes to the unique needs and statutory requirements of its industry segment, the FFIEC plays a key role in promoting general consistency among member agencies. Members of the FFIEC also participate in joint rulemaking and statement initiatives.

Q.4.c. What is the importance of the FFIEC to promoting the safety and soundness of our financial system?

A.4.c. The FFIEC facilitates consistency in supervisory policies, information sharing on risks, the establishment of consistent examination procedures, and the pooling of resources to ensure consistent training on technical topics and examination procedures. The networking also allows the agencies to exchange information and ideas on patterns, practices, and examination outcomes to better evaluate the effectiveness of programs individually and collectively. To that end, the FFIEC is central to promoting safety and soundness for the financial system.

Q.5.a. I've noticed an uptick in the number of credit unions buying banks. Given the regulatory challenges that would be involved with a bank trying to buy a credit union, this pattern of transactions seems like a one way street. In your forthcoming rulemaking regarding banks buying credit unions:

How do you intend to help level the playing field?

A.5.a. Credit unions do not buy banks. Credit unions cannot acquire bank charters. In some instances, credit unions purchase the assets and/or deposits of banks that choose to sell said assets and deposits. The vast majority of credit unions and community banks do not engage in such merger activity. When such occasions do arise, they are arms-length, market-based transactions that make economic sense to the institutions involved. All transactions must be pre-approved by the NCUA, the FDIC, and, in the case of a State-charted institution, the State regulator. Further, these transactions are explicitly authorized by the Federal Credit Union Act.

The playing field between banks and credit unions has always been different by design. The structure of credit unions is fundamentally different from that of banks, and in light of the numerous statutory and regulatory restrictions imposed on credit unions by Congress and the NCUA, it is not surprising that most banks do not choose to switch their charters in favor of credit union charters.

The Federal Credit Union Act severely limits credit union growth in multiple ways, including by limiting their customer base (otherwise known as "field of membership"); imposing a cap on the amount of member business loans credit unions may make; preventing credit unions from issuing common stock and other equity; imposing an interest rate ceiling and fee caps on credit union lending; and imposing a variety of restrictions on the types of investments credit unions may make.

It has been suggested by some that these transactions are a reflection of credit unions taking undue advantage of their tax-exempt status. Credit unions are tax-exempt institutions because they are not-for-profit, member-owned cooperatives and, as noted above, are subject to substantial growth, investment, and other restrictions that do not apply to banks.

The NCUA's recent proposed rule, which was adopted unanimously by the NCUA Board on January 23, 2020, is designed to clarify the agency's supervisory process for the parties engaging in these transactions. The Federal Credit Union Act specifically authorizes these transactions but also requires the NCUA's prior approval before they may be consummated. When a Federal credit union purchases the assets or deposits of a bank, NCUA requires a two-step process to establish the membership status of the former bank's customers. First, the Federal credit union must confirm that the bank customers are within the Federal credit union's field of membership. Second, the former bank's customers must become full members of the Federal credit union. For State-chartered credit unions, the State regulatory agency determines membership eligibility and credit union membership. Since the Federal Credit Union Act requires the NCUA to consider improving or denying proposed transactions, restating these factors in the proposed rule increases stakeholder awareness of them.

The number of credit union purchases of bank assets and certain liabilities is small relative to any standard. Since 2012 credit unions have purchased the assets or liabilities of roughly 30 banks. This is comparable to the 36 federally insured credit unions that were converted to, or merged into, banks between 1995 and 2013. We should recognize that these transactions are occurring at a time when options for financial services are dwindling in far too many of our local communities, especially in rural areas. These transactions may be particularly beneficial for underserved and rural communities, which have seen a severe contraction in access to financial services over the last decade as financial institutions close branches.

When communities lose access to financial services providers, it's like cutting off the oxygen to the local economy. Small businesses suffer; jobs are lost; and consumers, especially low-income households, are more likely to turn to less carefully regulated predatory lenders. If a credit union merging with a local bank allows for continued access to financial services when those services might otherwise have been lost, then that's an outcome we should encourage.

Q.5.b. What transparency promotion measures do you intend to include?

A.5.b. At its January 23 meeting, the NCUA Board approved a proposed rule to address transactions between federally insured credit unions and other types of institutions. The proposed rule does not provide new authorities for federally insured credit unions. Rather, it clarifies the NCUA's requirements and processes for considering transactions authorized in section 205 of the Federal Credit Union Act.

The proposed rule reflects the Act's mandate that the NCUA consider factors related to member service, as well as safety and soundness, in evaluating these transactions. The rule is intended to clarify what the NCUA requires to fulfill its statutory mandate. The proposed rule includes the following provisions:

- An express list of factors the NCUA will weigh in determining whether to approve such transactions. These considerations are required by statute, but the proposed regulation would reiterate the statutory requirements to increase stakeholder awareness.
- Express provisions to ensure compliance with credit union membership requirements. These requirements apply regardless, but the NCUA wants to ensure that stakeholders have appropriate notice of its expectations.
- An express list of the minimum required components of an application package, particularly addressing due diligence and safety and soundness.
- A provision requiring a vote of a credit union's board of directors and a detailed certification requirement from each member of a credit union's board of directors who voted in favor of such a transaction. This vote and certification requirement are designed to ensure a credit union's board of directors is fully informed about any such potential transaction and its implications.

RESPONSE TO WRITTEN QUESTION OF SENATOR MORAN FROM RODNEY E. HOOD

Q.1. During your confirmation hearing earlier this year, both you and now-Board Member Harper were asked about possible improvements to the National Credit Union Administration's Central Liquidity Facility that would make it better able to quickly and efficiently serve liquidity needs of the credit union system.

Can you provide an update on this issue, particularly in terms of any specific regulatory improvements to the CLF's operations and functionality being considered under your direction as Chairman?

A.1. Consistent with the spirit of President Trump's regulatory reform agenda and Executive Order 13777, the NCUA reviewed its regulations in 2017 and published a regulatory reform agenda that includes Part 725, the Central Liquidity Facility regulation. The original agenda remains in place; that is, to update the regulation where appropriate, allow for the use of nonmember correspondent institutions to provide certain operational services to the CLF, and to reduce the minimum collateral requirements of member credit unions for certain loans/collateral.

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

Q.1. Montana, and many areas of the country, face challenges of housing availability, affordability, and aging housing stock. As you know, this is a significant issue for rural as well as urban areas and is one of the largest barriers to success nationally. In Montana, lack of workforce housing is one of the greatest inhibitors of economic development.

Q.1.a. What can be done to increase workforce housing and encourage more affordable housing to be built?

A.1.a. Reducing burdensome regulation can play a critical role in ensuring a growing supply of affordable housing. I have always been a proponent of ensuring that regulations are effective, but not excessive. In my first months as NCUA's Chairman, I have worked hard to find areas in which we could roll back burdensome rules without jeopardizing safety and soundness. My firm belief is that a similar, concerted vision from local, State, and other Federal authorities could help make a dent in the problem.

Q.1.b. What do you see as the largest barrier to affordable housing, particularly in rural areas?

A.1.b. I agree with HUD leadership and other industry observers who recognize that supply constraints are a critical part of the problem. Barriers to construction, including burdensome regulations, have played an outsized role in limiting the number of new homes under construction in the United States. Indeed, despite recent increases, the pace of new home construction, both single-family and multi-family, is well below what would be expected, given population growth and historical norms.

Q.1.c. How has the [Fed/FDIC/NCUA] worked to support housing? Where is there room for additional efforts?

A.1.c. Credit unions provide affordable mortgage financing to many Americans. Credit unions provide attractively priced mortgages to their members and do so responsibly. Through both strong economic times and more challenging ones, the industry has provided mortgage loans with a strong track record of performance.

While credit unions have played a positive role in improving affordability, NCUA and the industry at large cannot rest. By adhering to my key guiding principle—that regulation should be effective, but not excessive—I hope to ensure that NCUA does everything possible to support affordable housing. In my first year as NCUA's chairman, NCUA has already taken steps that should mitigate the problem. For instance, the NCUA board voted to propose to raise the appraisal threshold for residential loans, thereby decreasing the costs of loan origination for thousands of borrowers.

Q.2. I appreciated the responses to my questions during the hearing, and the focus on supporting our farmers and ranchers and their families through the current challenges facing the agriculture sector while continuing to prioritize the safety and soundness of our community financial institutions.

Is there anything that you would like to add on this topic?

A.2. I appreciate the opportunity to expound on this important topic. I am passionate about addressing the needs of rural and other potentially underserved communities. This is an area that hits home to me. I am a proud, native North Carolinian, where more than one-third of the population lives in rural areas, and I have strong family ties to the countryside. Credit unions, with their historical grounding as a comprehensive, member-owned system of affordable financial services for underserved communities, plays an important role in fostering economic development in our rural and agricultural areas across the country. This mission is particularly urgent at this time, as many financial institutions have pulled out of rural America in the past few decades.

Since I had the privilege of becoming Chairman of the NCUA last spring, the agency has taken important steps that I believe can play a positive role in supporting our rural communities. First, the NCUA Board finalized a rule raising the appraisal threshold for commercial real estate loans. This will reduce the regulatory burden for rural entrepreneurs and spur more lending in their communities. In making this rule change, the NCUA conducted extensive comparative analysis and due diligence and also instituted a number of safeguards attached to such loans. I have every confidence this rule change will uphold the safety and soundness of the credit union industry and present no undue risk to the Share Insurance Fund.

The NCUA was also the first Federal financial regulator to issue guidance on how federally insured credit unions could provide financial services to the now-legal hemp industry. A thriving hemp industry should be a significant boost for rural America, and NCUA will continue to work with credit unions serving these communities to make sure they are aware of the full regulatory landscape in providing capital and financial services to this burgeoning agricultural industry.

Through these measures, the NCUA will continue to balance its foundational aspirations of cooperative credit and "people helping people" with its statutory obligation to protect the Share Insurance Fund and the safety and soundness of the overall credit union industry.

Q.3. Thank you all for your updated guidance on providing financial services to the hemp industry. As you know, this is an issue that has been very important to me. Montana leads the country in hemp production, and this guidance will help our producers and the financial institutions that are now able to serve them.

Q.3.a. What will your agencies be doing to educate your examiners and the institutions that you oversee to adapt to working with hemp-related businesses?

A.3.a. The NCUA issued a Regulatory Alert in August 2019 on credit unions serving hemp-related businesses. In addition, the agency conducted a webinar in December 2019 with State regulators on this topic and a webinar with NCUA staff in January 2020. The agency is in the process of putting together a frequently asked questions document that will be available on the NCUA's website. Agency staff will continue to work with the banking agencies, the USDA, and FinCEN to jointly develop and provide additional guidance and information.

Q.3.b. Are there areas that you anticipate will require additional guidance?

A.3.b. We will continue to ensure that credit unions are aware of all the laws and regulations concerning hemp regulations.

RESPONSE TO WRITTEN QUESTION OF SENATOR MENENDEZ FROM RODNEY E. HOOD

Q.1. Despite changes in the market, many taxi medallion loans continue to perform. This is especially true where credit unions have worked with owners to adjust the terms of their loans to ensure they are affordable. I have heard concerns that NCUA examiners are applying taxi medallion loan valuation methodologies inconsistently, forcing credit unions to lower the value of taxi medallion loans immediately regardless of cashflows and whether they are performing.

Does NCUA plan to codify valuation criteria as guidance to reduce the uncertainty that currently exists among credit unions regarding the NCUA's current approach to loan valuations?

A.1. NCUA's role does not include codifying market valuation criteria. As you know, there is no one-size-fits-all approach to valuing taxi medallions or taxi medallion loans, and efforts to valuate are complicated by the fluctuating value of the medallions.

Generally Accepted Accounting Principles (GAAP) establish the approach for valuing loans and other assets. NCUA examiners focus on ensuring the reasonableness of a credit union's valuation method and adherence to GAAP. At times, credit unions may obtain independent third-party valuations of their taxi-medallion loans that, in some cases, rely on cashflow analysis.

To ensure consistency in its approach to supervising credit unions with taxi-medallion loan portfolios, the agency issued public-facing guidance in 2014 to provide examination staff with procedures to review taxi-medallion loan portfolios. This guidance is still in effect and outlines the various factors that can influence the value of a taxi medallion and the factors examiners should consider when reviewing taxi medallion loans.

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

Q.1.a. In the past three years, the open balance of auto loans held by credit unions has grown from $305.1 billion to $358.6 billion, and credit unions have the second-highest market share of used auto financing.[1] Auto loan delinquencies are now at their highest rate in the past two decades, with more than 7 million Americans at least 90 days late on an auto loan.

[1] Experian, "State of the Automotive Finance Market Q3 2019," Melinda Zabritski, Fall 2019, *https://www.experian.com/content/dam/marketing/na/automotive/quarterly-webinars/credit-trends/2019-q3-experian-automotive-safm.pdf.*

How are you monitoring the rising balance of auto loans held by credit unions, and what is your assessment of this growth?

A.1.a. Credit union exposure to auto lending has not significantly increased related to asset growth, and loan performance remains strong. Call Report data from 2017 to third quarter 2019 show the compound annual growth rate for auto loan balances was 7.0 percent. The growth rate for total assets for the same period was 7.1 percent.

On a quarterly basis, the NCUA analyzes auto-lending data using the information credit unions are required to submit as part of the 5300 Call Report process. NCUA also conducts various other risk-management functions pertaining to auto lending.

Q.1.b. Auto loans issued by credit unions have the lowest 30- and 60-day delinquency rates relative to other types of lenders, and these rates have remained relatively steady for the past few years. What is keeping credit union default rates lower than other types of lenders, and do you anticipate any future rises in defaults on auto loans held by credit unions? If so, how are you ensuring credit unions are prepared for those rising defaults?

A.1.b. Credit unions have a long history of making auto loans in a safe and sound manner. Credit union delinquency rates are lower than those of other auto lenders. The agency attributes this to the fact that credit unions generally make higher-quality loans.

While credit unions have the second highest market share among all used car loans, we note that average credit scores in credit union portfolios are higher than the overall lending-industry average. Auto loans that meet the criteria for prime and superprime categories have significantly lower expected defaults than those in the subprime and deep subprime categories. According to Experian, for all auto lending, more than 60 percent of loans are prime and superprime. For credit unions, approximately 80 percent of loans are prime and superprime.

Based on the high quality and strong history of underwriting, we currently do not anticipate rising delinquency or loan loss rates in their auto loan portfolios. Credit unions have the capital and risk management capabilities to address any rise in defaults.

Q.2. Please describe what the NCUA views as the greatest risks to the Share Insurance Fund. For each area of risk identified, describe what the NCUA is doing to monitor and address those risks.

A.2. The NCUA uses an Enterprise Risk Management program to evaluate various factors arising from its operations and activities, both internal to the agency and external in the industry, that can affect the agency's performance relative to its mission, vision, and performance outcomes. Agency priority risks include both internal considerations, such as the agency's control framework, information security posture, and external factors, such as credit union diversification risk. All of these risks can materially impact the agency's ability to achieve its mission.

The NCUA has conducted several risk response assessments for priority areas, including: credit union business diversification, credit union cybersecurity, agency controls, and information security. These assessments help inform the agency's activities, operations, and planning and budget processes.

Collaboration across programs and functions is a fundamental part of ensuring the agency stays within its risk appetite boundaries, and the NCUA will identify, assess, prioritize, respond to and monitor risks to an acceptable level. The 2020–2021 budget incorporates several specific programmatic changes that resulted from the NCUA's enterprise risk management reviews, such as hiring new personnel focused on cybersecurity, acquiring data loss prevention and other network security tools, and strengthening analytical focus on emerging financial risks within the credit union system.

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

Q.1. Did you or your staff consult with the Office of Government Ethics before you chose to appear in the White House video and/ or golfing photos supporting the President? If so, what did they say about the video of you praising the President and the photos of you golfing with the President at his golf resort?

Q.2. Did you or your staff consult with the U.S. Office of Special Counsel before you chose to appear in the White House video and/ or golfing photos supporting the President? If so, what did they say about the video and the photos of you golfing with the President at his golf resort?

Q.3. Where was the video supporting the President shot?

Q.4. Who wrote the script for the video?

Q.5. Who decided to post the video on the White House Twitter feed?

Q.6. Who paid for the trip to the President's golf resort?

Q.7. How often do you golf with the President at his resorts?

Q.8. Did you consult with the other NCUA board members before making the video and posting it on NCUA's Twitter account or other online sites?

Q.9. Do you plan to record videos supporting the President in the future?

A.1.–A.9. I am committed to ensuring that NCUA follows all applicable laws, including all ethics laws. As a general practice, I consult with the appropriate officials at the agency when there are ethics-related questions. If you have additional concerns, I am happy to have staff brief you further on this issue.

Q.10. This spring, the Office of Management and Budget issued a memorandum that for the first time required independent regulatory agencies such as yours to submit final rules to the Administration before publishing them.

Q.10.a. Did NCUA run its payday alternative loan final rule, real estate exemption, your secondary-chance hiring policy rule or other rule by OMB before publishing them? If so, which ones?

A.10.b. Did OMB staff ask you to make any changes to any of the rules? If so, what changes did they request?

A.10.a.–A.10.b. The following is a list of all the final rules issued by the NCUA from the beginning of my tenure as Chairman to date. Aside from the rule finalizing an internal office name change at 12 CFR part 790, the agency submitted all these to the Office of Management and Budget. OMB did not ask for any changes.

12 CFR Part 702	Delay of Effective Date of the Risk-Based Capital Rules	12/12/2019
12 CFR Parts 701 and 741	Public Unit and Nonmember Shares	10/24/2019
12 CFR part 715	Supervisory Committee Audits and Verifications	9/19/2019
12 CFR Part 701	Payday Alternative Loans	9/19/2019
12 CFR Parts 701, Appendix A, and 746	Federal Credit Union Bylaws	9/19/2019
12 CFR Part 790	Office Name Change	7/30/2019
12 CFR Parts 704 and 713	Fidelity Bonds	7/18/2019
12 CFR Part 722	Real Estate Appraisals	7/18/2019
12 CFR Part 701	Loans to Members and Lines of Credit to Members	3/14/2019
12 CFR Part 760	Loans in Areas Having Special Flood Hazards	2/1/2019
12 CFR Part 747	Civil Monetary Penalty Inflation Adjustment	1/4/2019

Q.11. There remains a persistent gap in home ownership among Americans with different ethnicities. According to the U.S. Census Bureau, in the third quarter of 2019, 73 percent of White households owned their home, compared to less than 43 percent of Black households and 48 percent of Latino households. What, if anything, is the NCUA doing to encourage sustainable and affordable home ownership among credit unions' members?

A.11. Credit unions currently play a critical role in facilitating affordable home ownership. In the first three quarters of 2019, the annualized pace of real estate lending for federally insured credit unions exceeded $190 billion. In many cases, mortgage rates for credit union loans are significantly below rates charged by other financial institutions. In terms of sustainability, I would stress that credit union mortgages traditionally have had significantly low default rates relative to other loans. Although NCUA always will remain vigilant in ensuring that underwriting standards are safe and sound, the strong historical loan performance indicates that mortgage sustainability has been a critical industry value.

I have been a strong proponent of ensuring that regulation is effective, but not excessive. That principle has played a critical role—and will continue to do so—in facilitating affordable home ownership among credit union members. Last year, for instance, NCUA proposed to increase the appraisal threshold for residential mortgages originated by credit unions. That effort will decrease loan origination costs for a significant number of borrowers in the years ahead.

Q.12. Nevada, and many other States across the Nation, are facing an affordable housing shortage, with only 17 units available per every 100 extremely low-income families. Rents are rising at twice the rate of inflation nationally. More than one in three rental households pay more than a third of their income on rent. Nearly half of African American rental households are rent burdened. Is

NCUA proposing any initiatives to encourage investments in affordable rental housing?

A.12. Rental housing is of critical importance to Americans and we understand that costs have been rising sharply. While credit unions operate under certain constraints that, to an extent, hinder their ability to invest in large-scale rental housing, NCUA will do its utmost to remove any inappropriate regulatory roadblocks. Although our mission entails ensuring the safety and soundness of the credit union system, we do not need to be adversarial with our regulated entities. Consistent with our mandate, we will strive to ensure that they have the tools necessary to develop financing options that help to address this problem while remaining within the bounds of safety and soundness.

NCUA is aware that some affordable housing organizations are assessing how to harness investment in affordable rental housing through the new Opportunity Zones program that Congress enacted in 2017. That program has the potential to unlock significant investment in housing, community development, and new business growth. NCUA is currently looking at how we may encourage credit unions to engage with that program and promote their local knowledge and expertise to outside investors.

Q.13. The Task Force on Climate-related Financial Disclosures publishes an annual report on climate-related business risks. Can you name three business risks that you are concerned about and what you plan to do to address them?

A.13. The NCUA uses an Enterprise Risk Management program to evaluate various factors arising from its operations and activities, both internal to the agency and external in the industry, that can affect the agency's performance relative to its mission, vision, and performance outcomes. Agency priority risks include both internal considerations, such as the agency's control framework, information security posture, and external factors, such as credit union diversification risk. All of these risks can materially impact the agency's ability to achieve its mission.

The NCUA has conducted several risk response assessments for priority areas, including: credit union business diversification, credit union cybersecurity, agency controls, and information security. These assessments help inform the agency's activities, operations, and planning and budget processes.

Collaboration across programs and functions is a fundamental part of ensuring the agency stays within its risk appetite boundaries, and the NCUA will identify, assess, prioritize, respond to, and monitor risks to an acceptable level. The 2020–2021 budget incorporates several specific programmatic changes that resulted from the NCUA's enterprise risk management reviews, such as hiring new personnel focused on cybersecurity, acquiring data loss prevention and other network security tools, and strengthening analytical focus on emerging financial risks within the credit union system.

RESPONSE TO WRITTEN QUESTION OF SENATOR CRAMER FROM RODNEY E. HOOD

Q.1. This Committee is considering legislation that would aim at providing some regulatory certainty to banks working with cannabis-related companies in the 47 States that have taken various steps towards legalization. Would legislation such as the SAFE Banking Act be a constructive step toward providing a framework for financial institutions to serve companies that comply with State cannabis laws?

A.1. All credit unions must comply with the Bank Secrecy Act and anti-money laundering regulations, along with FinCEN requirements. The decision to open, close, or decline a particular account is made by credit union management.

RESPONSE TO WRITTEN QUESTION OF SENATOR JONES FROM RODNEY E. HOOD

Q.1. Starting a credit union, or any depositary institution, has a high barrier to entry. Entrepreneurs must tackle several hurdles including obtaining substantial funds before even applying for a charter. This leads to less competition for consumers and disincentives financial institutions to find innovative ways to serve consumers. What steps are you taking to encourage more new credit unions, especially among women and people of color?

A.1. The agency is always looking for new incentives for credit unions and ways to encourage the creation of new MDI credit unions. For example, one of my priorities is to enhance and modernize the Federal credit union chartering process with the goal of encouraging the creation of MDIs and promoting greater financial inclusion.

The NCUA is undertaking a modernization initiative in order to encourage new credit union formation. This all-inclusive review consists of analyzing current regulations to ensure they support startups that thrive in today's financial services industry as well as associated application procedures to ensure transparency and ease of use. The modernization initiative will culminate in a more streamlined and efficient chartering process.

As a first step to the modernization process, NCUA launched a proof-of-concept chartering tool this past year. This online tool takes the prospective credit union organizer through a series of questions that help define the proposed credit union. As the organizer moves through the proof-of-concept, the credit union's name, potential products and services offered, and proposed field of membership are defined. The proof-of-concept is also an educational tool, informing organizers about Minority Depository Institutions and their ability to self-identify as an MDI if their proposed credit union will represent and support a minority community. This is a preparatory step for the organizers to determine whether or not they would like to move forward with a new charter application.

In conjunction with the proof-of-concept, the NCUA is developing template documents in order to take the guesswork out of what is required to charter a new credit union. Business model templates, financial projection spreadsheets, and a capital estimator tool assist the organizers as they complete the new charter application.

Online training is also available, with topics covering board governance, internal controls, and loan underwriting.

The largest impediment faced by organizing groups is the accumulation of required capital. Consumers want easy access to cash and credit services, which can be costly to implement, especially for newly formed institutions. Depending on the types of products and services the new credit union intends to offer members, startup capital can be $1 million or more. NCUA is researching other sources of capital available to charter credit unions.

NCUA has designated staff whose main responsibility is working with organizing groups to charter new credit unions. The agency provides one-on-one support to organizing groups as they work through the chartering process. Once the credit union is chartered, NCUA examiners play an integral role in assisting the newly chartered credit union during its first years of operations.

Specific to MDIs, the NCUA has an MDI Preservation Program to assist these institutions. This MDI program provides needed support to federally insured credit unions that serve communities and individuals who may lack access to mainstream financial products and services. In many cases, our examiners in the field and CURE Office staff provide ongoing assistance to MDIs by working directly with them, sharing their knowledge of the credit union system and best practices, coordinating mentor relationships between large and small credit unions, and generally acting as a knowledgeable point of contact and resource. MDIs can qualify for funding initiatives, such as MDI Mentoring Grants, where mentor credit unions match up with MDI mentee credit unions for technical assistance and other support needs. The NCUA makes training available to credit unions through an online training portal as well as webinars covering information of importance for credit union volunteers, management, and staff.

Additional Material Supplied for the Record

Credit Union National Association
CUNA

Jim Nussle
President & CEO

Phone: 202-508-6745
jnussle@cuna.coop

99 M Street SE Suite 300
Washington, D.C. 20003-3799

December 4, 2019

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

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

Dear Chairman Crapo and Ranking Member Brown:

On behalf of America's credit unions, I am writing regarding the Committee's hearing entitled, "Oversight of Financial Regulators." The Credit Union National Association (CUNA) represents America's credit unions and their 115 million members.

On behalf of America's credit unions, I am writing regarding the Committee's hearing entitled, "Oversight of Prudential Regulators: Ensuring the Safety, Soundness, Diversity, and Accountability of Depository Institutions." The Credit Union National Association (CUNA) represents America's credit unions and their 115 million members.

This April, during his first NCUA Board meeting as chair, Chairman Hood highlighted several priorities, including enhancing the credit union charter, enhancing cybersecurity efforts, and reducing regulatory burden. Below we identify several issues within and outside the Chairman's priorities where we have seen positive steps by the agency, as well as issues within and outside his priorities where improvements can be made.

Recent NCUA Actions that Have Been Positive for Credit Unions

Under Chairman Hood's leadership, we are optimistic that NCUA will continue to take actions that result in increased flexibility and decreased compliance requirements for credit unions. We appreciate the following recent actions taken by NCUA that have been positive for credit unions.

Cybersecurity:
Concern over cyber and data security is likely the single biggest issue currently facing most industries, including financial services. We appreciate NCUA's recognition of the importance of this issue and its commitment to make it a focus area. We are supportive of Chairman Hood's recent efforts to bolster the agency's involvement in cybersecurity, including through elevating the agency's relationship with other government agencies working in this area. At a recent NCUA Board meeting, Chairman Hood's new Cybersecurity Advisor Johnny Davis provided the Board with a comprehensive look at cyber issues of concern and NCUA's plan to address such issues. We look forward to continued updates as well as additional resources from the agency on cyber and data security.

Regulatory Burden:
We also appreciate the agency's commitment to address unnecessary regulatory burden. We support NCUA's decision—even though it is an independent agency—to respect the spirit and intent of the Presidential Executive Order to reduce regulatory burden. We encourage it to continue to do so. Further, we appreciate recent regulatory relief that has been achieved as a result of the work of the agency's Regulatory Reform Task Force.

Budget Transparency:
We commend the agency for continuing to provide comprehensive budget information as well as rationalization of the budget and agency expenditures in the context of a well-communicated strategic plan. Providing budget items in advance, holding an open briefing where stakeholders are invited to comment, and soliciting written comment is good public policy and reflects the agency's commitment to government transparency.

Extended Examination Cycles:
The NCUA's recent effort to extend the examination cycle for certain credit unions has benefited numerous well-managed, low risk federal credit unions, particularly those for which a 12-month cycle was clearly unnecessary.

Examination Improvements:
We appreciate the NCUA's efforts to streamline examinations and make operations more efficient, and we urge the agency to continue these efforts. Further, we support the NCUA's move toward virtual examinations, provided credit unions have the ability for in-person interaction to allow them to engage with examiners.

Modernization of the Call Report:
We support the NCUA's work to modernize the call report. On a going-forward basis, we request the agency continually monitor the call report to determine how it can be further improved.

Areas Where the NCUA Can Improve

While we appreciate the NCUA's recent actions, there are nevertheless issues and rulemakings that cause concern for the credit union industry. We urge the NCUA Board to maintain an open dialogue with CUNA, the state credit union leagues and associations, and credit unions to ensure it is aware of areas where improvements can be achieved.

Risk-Based Capital (RBC):
The NCUA's rulemaking on risk-based capital is a prime example of where we believe the NCUA can make improvements. During the rulemaking process, credit unions across the country expressed significant concerns with the new standards, particularly regarding whether the NCUA has legal authority to impose the requirements. Credit unions have concerns with the new risk-based capital standards for determining whether a credit union is well-capitalized, as the Federal Credit Union Act permits the NCUA to impose a risk-based standard for the purpose of determining capital adequacy only.

In addition, credit unions question whether the cost of the additional regulatory burdens imposed by these standards is justified. CUNA's analysis shows that it would have done very little to reduce costs to the National Credit Union Share Insurance Fund (NCUSIF) had it been in effect during the most recent financial crisis. Upon reflection, the current Prompt Corrective Action (PCA) system served very well during the crisis, with relatively few credit union failures. If the goal of a PCA scheme is for covered institutions to hold sufficient capital to withstand a severe financial crisis without imperiling the deposit insurance fund, credit unions' performance during the recent financial crisis stands as compelling evidence that a major overhaul of current credit union capital requirements toward a Basel-style system is simply not required. While we appreciate the Board's pending proposal to further delay the effective date of the RBC rule, we continue to believe the rule is a solution in search of a problem.

Current Expected Credit Loss Standard (CECL):
While outside the NCUA's rulemaking authority, the Financial Accounting Standards Board's (FASB) CECL accounting standard will have a significant financial and compliance impact on credit unions.

We appreciate Chairman Hood's recent announcement that the agency will be pursuing a rulemaking to provide a multi-year phase-in of CECL for regulatory capital purposes. We have encouraged the agency to pursue such a rulemaking since early this year, particularly since the banking regulators recently adopted a similar rule.

However, we encourage the NCUA to employ a more proactive and collaborative strategy with industry stakeholders to better ensure credit unions are prepared for this major change as the effective date—though recently delayed by FASB—is not far off. Preparation for credit unions to comply with the CECL standard should be a top priority for the NCUA, and we hope Chairman Hood will ensure the NCUA is doing everything it can in this regard.

Regulatory Burden:

As noted above, we appreciate the agency's efforts to address unnecessary regulatory burden, including, in part, through the work of the agency's Regulatory Reform Task Force. However, it is our understanding that with the release of its second report the work of the Task Force is finished. While regulatory relief is an identified priority of the Chairman, we are concerned that the absence of a concrete, public plan to achieve such relief may hinder the agency's continued success in this area. Therefore, we ask the agency to provide a clear roadmap of where it intends to go and how it plans to get there.

Extended Examination Cycle:

As noted above, we appreciate the NCUA's recent effort to extend the examination cycle for certain credit unions has benefited numerous well-managed, low risk federal credit unions. The federal banking agencies recently issued a final rule implementing a provision of the Economic Growth, Regulatory Relief, and Consumer Protection Act to give banks holding under $3 billion in assets an examination only once every 18 months, leaving credit unions on an uneven playing field. Credit unions, however, remain eligible for an 18-month examination cycle only if their asset level is below $1 billion. This regulatory disparity now serves as a comparative advantage for community banks.

Congress has already delegated authority to NCUA to set the frequency of examinations for credit unions. Credit unions deserve the privilege of providing customer service subject to comparable regulatory supervisory thresholds as applied to banking organizations—and this issue continues to be a concern among industry leadership. We urge the NCUA to extend the credit union asset threshold for the 18-month examination cycle from $1 billion to $3 billion.

NCUSIF Normal Operating Level (NOL):

In December 2018, the NCUA Board approved a reduction of the NOL from 1.39% to 1.38% for 2019. We thank NCUA for acting to lower the NOL and encourage NCUA to issue additional NCUSIF distributions whenever possible with the expectation that the initial increase in the NOL was temporary. We look forward to a phase-down of the NOL to 1.30% by 2021.

In the interest of transparency, we encourage the agency to more regularly share its views on the possible return of capital from conserved corporate credit unions. Credit unions deserve more information and discussion on the mechanics and considerations surrounding the decisions to sell or manage securities of the various estates after the NCUA Guaranteed Notes are retired.

Proposed Expansion of Office of Consumer Protection:

NCUA Board Member Harper, as a supplement to the agency's budgetary process, has proposed the expansion of the agency's Office of Consumer Financial Protection with the goal of creating a dedicated consumer compliance examination program for "large, complex credit unions." While this proposal may be well-intentioned, we believe altering the agency's risk-focused examination process and substantially increasing examination-related expenditures is not warranted. There has been no supplementary evidence introduced or observed to suggest credit unions' consumer compliance management has become a risk area warranting an increased expenditure of agency resources. Absent evidence demonstrating an emerging need or establishing a clear benefit to all credit unions, our members view the proposal as a solution in search of a problem. While this proposal has been put forth by Board Member Harper, we encourage Chairman Hood to offer the voice of reason when and if the Board pursues a rulemaking on this issue.

Importance of NCUA Coordination with Other Regulators

We emphasize the importance of the NCUA's continued coordination with other federal regulatory agencies. As the prudential regulator and federal insurer, the NCUA retains significant oversight over a credit union's operations. However, there are other agencies that examine and/or regulate credit union operations, such as the Consumer Financial Protection Bureau regarding certain consumer financial protection laws and regulations, and the Federal Communications Commission in regard to certain consumer protections including the Telephone Consumer Protection Act. It is critical that the NCUA work closely with these and all agencies affecting credit union operations.

Conclusion

On behalf of America's credit unions and their 115 million members, thank you for holding this important hearing and considering our views.

Sincerely,

Jim Nussle
President & CEO

NAFCU
3138 10th Street North
Arlington, VA 22201-2149
703.522.4770 | 800.336.4644
f: 703.524.1082
nafcu@nafcu.org | nafcu.org
National Association of Federally-Insured Credit Unions

December 4, 2019

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

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

RE: Tomorrow's Hearing on Oversight of Financial Regulators

Dear Chairman Crapo and Ranking Member Brown:

I am writing on behalf of the National Association of Federally-Insured Credit Unions (NAFCU) to share our thoughts ahead of tomorrow's hearing entitled "Oversight of Financial Regulators." NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 118 million consumers with personal and small business financial service products. NAFCU and our members welcome the Committee's oversight of financial regulators.

Since the financial crisis, the credit union industry has lost over 1,500 institutions. This dramatic consolidation is due, in large part, to increased regulatory compliance requirements. We urge you to continue to work to create a regulatory environment where credit unions can grow and thrive. As we have previously communicated to you, NAFCU supports the following five tenets of a healthy regulatory environment:

- **NAFCU supports a regulatory environment that allows credit unions to grow.** NAFCU believes that there must be a regulatory environment that neither stifles innovation, nor discourages credit unions from providing consumers and small businesses with access to credit. Promoting growth-friendly regulation includes protecting the current tax status of credit unions. It also includes the ability of credit unions to establish healthy fields of membership that are not limited by outdated laws or regulatory red tape. All credit unions should have the ability to add underserved areas to their fields of membership. Revised regulations may also be necessary to address structural barriers to growth. For example, credit unions need modernized capital standards that reflect the realities of the 21st century financial marketplace, such as the ability to issue supplemental capital. Additionally, there must be a housing finance system that works for credit unions.

- **NAFCU supports appropriate, tailored regulation for credit unions and relief from growing regulatory burdens**. Credit unions are swamped by unabated regulatory burden from the Consumer Financial Protection Bureau (CFPB) and other regulatory entities, often from rules that are targeting bad actors and not community institutions. NAFCU supports the adoption of cost-benefit analysis in the rulemaking process to ensure that positive regulations may be easily implemented and negative ones may be quickly eliminated. NAFCU also believes that enforcement orders from regulators should not take the place of regulation or agency guidance to provide clear rules of the road. This NAFCU priority includes seeking regulatory relief and reform that allows credit unions to better serve their members. This includes changes to modernize the Federal Credit Union Act, such as giving the National Credit Union Administration (NCUA) authority and flexibility to set longer loan maturity limits, improving credit union investment options, and updating outdated statutory credit union governance provisions found in the Act, including the ability for credit unions to deal with threats to the institution in a timely manner.

- **NAFCU supports a fair playing field.** NAFCU believes that credit unions should have as many opportunities as banks and non-regulated entities to provide provident credit to our nations' consumers. NAFCU wants to ensure that all similarly situated depositories and lenders follow the same rules of the road and unregulated entities, such as predatory payday lenders, do not escape oversight. We also believe that there should be a federal regulatory structure for non-bank financial services market players that do not have a prudential regulator, including emerging fintech companies. Additionally, retailers and others who handle personal financial information should be held responsible for protecting that information. Retailers should also pay their share for costs associated with data breaches and for access to a reliable and secure national payments system.

- **NAFCU supports government transparency and accountability.** NAFCU believes that regulators need to be transparent in their actions, with the opportunity for public input, and should respect possible different viewpoints. We believe a bipartisan commission is the best form of regulatory governance structure for independent agencies, and all stakeholders should be able to provide feedback in the regulatory process.

- **NAFCU supports a strong, independent NCUA as the primary regulator for credit unions.** NAFCU believes that the NCUA is the sole regulator equipped with the requisite knowledge and expertise to regulate credit unions due to their unique nature. The current structure of the NCUA, including a three-person board, has a track record of success. The NCUA should be the sole regulator for credit unions and continue to work with other regulators on joint rulemaking and other initiatives when appropriate. Congress should make sure that the NCUA has the tools and powers that it needs to effectively regulate credit unions. However, NAFCU does not support the NCUA expanding its regulatory and examination authority beyond credit unions. We believe the NCUA should focus its resources on regulating and examining credit unions, rather than non-credit union third parties where it may not have the expertise or where there may be duplicative regulatory efforts.

In addition to these five tenets of a healthy regulatory environment, NAFCU would like to emphasize several challenging regulatory issues that we hope Chairman Hood and the NCUA Board will address:

- **Exam Modernization:** NAFCU generally supports the NCUA's commitment to modernizing its examination process so long as it reduces burdens on credit unions. Considering that credit unions continue to struggle with procedural inconsistencies and other exam-related issues, NAFCU advocates that the NCUA should prioritize its examination modernization initiatives to standardize examinations and relieve burdens, including the Flexible Examination Pilot Program (FLEX) or offsite examination procedures and the Virtual Examination Program. In particular, NAFCU urges the NCUA to use its authority to expand eligibility for an extended 18-month exam cycle for all well-run, low-risk credit unions. Banks already have increased access to extended exam cycles as authorized by Congress through the Economic Growth, Regulatory Relief, and Consumer Protection Act last year. NAFCU is pleased to see advancements in the implementation of the Enterprise Solution Modernization (ESM) program, which includes the replacement of the Automated Integrated Regulatory Examination System (AIRES) with the new Modern Examination and Risk Identification Tool (MERIT) system. Successful deployment of this new platform could provide cost savings for both credit unions and examiners. NAFCU supports the modernization of the agency's legacy AIRES system with a new platform capable of sharing data in real-time. This new platform could provide substantial efficiencies and help to facilitate more virtual examinations. However, NAFCU asks the NCUA to balance enhanced monitoring with respect for credit union autonomy – increased communication between examiners and credit union management to support virtual supervision should not interfere with day-to-day operations. We hope to see the agency leverage advancements in technology to reduce the length of exams, improve consistency, and reduce the overall burden on credit unions.

- **Risk-Based Capital (RBC) Rule:** NAFCU and its member credit unions support a fair capital system for all federally-insured credit unions that both provides true risk-based capital and access to supplemental capital. In October 2015, the NCUA adopted the RBC rule for federally insured, natural-person credit unions to create a two-tier risk-based capital system. The rule made significant changes to the NCUA's capital adequacy rules and was to take effect on January 1, 2019. In October 2018, the NCUA finalized a rule amending its 2015 RBC rule to delay the implementation date by one year to January 1, 2020 and increase the threshold level for coverage under the RBC requirements from $100 million to $500 million by amending the definition of a "complex" credit union. In June 2019, the NCUA proposed to delay the effective date of both the 2015 and 2018 final rules until January 1, 2022 to allow the agency more time to consider whether to: (1) develop regulatory and supervisory standards to address asset securitization; (2) propose and finalize a rule to allow certain forms of subordinated debt to qualify as capital for RBC purposes; and (3) integrate the equivalent of a community bank leverage ratio (CBLR) into the NCUA's capital standards. NAFCU urges the NCUA to finalize this delay and to permanently grandfather "excluded goodwill" and "excluded other intangible assets" in the RBC calculation. Considering that a credit union is considered to be well capitalized if it has a net worth ratio of 7 percent, and the aggregate net worth of the credit union system is over 11 percent according to the NCUA, the credit union system is already extremely well capitalized, and NAFCU does not think an additional delay of the RBC rule will pose a risk to safety and soundness. In summary, in any RBC regime, NAFCU has one key tenet that needs to exist: capital must be sufficient to protect the institution, but not so restrictive as to provide a competitive disadvantage or curtail lending.

- **Current Expected Credit Loss (CECL) Standard:** The Financial Accounting Standards Board's (FASB) CECL standard remains a major concern for credit unions. The CECL standard is the most significant change in accounting rules to hit the financial services industry in decades. NAFCU believes that there is a fundamental misalignment between FASB's objectives in developing the CECL standard and the credit union industry. As not-for-profit member-owned cooperatives, credit unions stand to be severely disadvantaged by this new standard and could be forced to curtail certain types of lending because of this standard. NAFCU has urged FASB to reconsider its approach to this proposal and provide an exemption for credit unions because the credit union industry was not responsible for the market conditions that caused the financial crisis. NAFCU appreciates FASB delaying implementation of the standard until 2023 for not-for-profits, including credit unions, but a delay is not enough. We ask the Committee to work with regulators such as the NCUA to come up with solution so that credit unions and their 118 million members are not harmed by, and have the resources necessary to understand, this new standard.

Finally, NAFCU asks the Committee to support several bipartisan pieces of legislation that are consistent with NAFCU's five tenets of a healthy regulatory environment and would help credit unions to better serve American consumers:

- **H.R. 1661, legislation to provide the NCUA Board flexibility to increase loan maturities.** The Federal Credit Union Act has a general statutory limit on federal credit union loans of 15 years, with a limited number of exceptions, such as mortgage loans for a primary residence. However, the Act does not have as much explicit flexibility for other types of loans and the NCUA's ability to address this through regulation may be limited. For example, many military members may purchase a home to move to when their service ends, but because it is not their current primary residence, they may be unable to obtain a loan with a term longer than 15 years. The current 15-year limit is outdated and does not conform to maturities that are commonly accepted in the market today. Language to raise the credit union general loan maturity limit from 12 to 15 years and to provide the NCUA greater flexibility to address loan maturity limits passed the House in 2006, as part of the efforts that led to P.L. 109-351, the Financial Services Regulatory Relief Act of 2006. However, the final version of the legislation only raised the limit to 15 years and did not include the language providing greater flexibility for the NCUA Board. In a rising interest rate environment, it is important that consumers have options for longer maturity products. Representatives Lee Zeldin (R-NY) and Vincente Gonzalez (D-TX) introduced H.R. 1661 on March 8, 2019, which mirrors the additional language that passed the House in 2006, and would clarify the NCUA Board's ability to establish longer maturities for other types of loans. The language does not extend any maturity limits on its own, rather just gives the NCUA Board the ability to do so if it deems necessary.

- **H.R. 2305, Veterans Members Business Loan Act.** Under the Federal Credit Union Act, a credit union's aggregate member business lending (MBL) is effectively capped at 12.25 percent of assets. Although credit unions have the capital to help small businesses thrive, credit unions' ability to help stimulate the economy is frustrated by the outdated MBL cap. This bipartisan bill offered by Representatives Vicente Gonzalez (D-TX), Paul Cook (R-

CA), Tulsi Gabbard (D-HI) and Don Young (R-AK) would exclude loans made to veterans from the statutory credit union MBL cap, thus improving veterans' access to necessary capital by removing regulatory barriers that hinder credit unions' ability to meet the financial needs of our nation's veterans.

- **Legislation to allow all credit unions to add underserved areas to their fields of membership.** Currently, only credit unions with multiple-group charters are able to add underserved areas to their fields of membership. NAFCU supports legislation that would allow other types of credit unions to seek the NCUA Board's approval to add such areas. Although this legislation has yet to be introduced this Congress, it was introduced last Congress as H.R. 4665, the Financial Services for the Underserved Act, by Representatives Gwen Moore (D-WI) and Paul Cook (R-CA).

In conclusion, we thank you for your leadership and ongoing oversight of prudential regulators. NAFCU is pleased to see the Committee examining ways to continue regular oversight. We urge you to also continue to consider additional measures that will help credit unions to better serve their members. We appreciate the opportunity to share our input and look forward to continuing to work with the Committee to balance minimizing regulatory burden with enhancing the safety and soundness of the credit union system. Should you have any questions or require any additional information, please contact me or Sarah Jacobs, NAFCU's Associate Director of Legislative Affairs, at 703-842-2231.

Sincerely,

Brad Thaler

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the Senate Banking Committee